Final Report November — 1989

Barber Commission

on SaskEnergy

90-01592/

The Barber Commission on
SaskEnergy Public Participation

LETTER OF TRANSMITTAL

October 30, 1989

The Honourable Premier Grant Devine
President of Executive Council
Room 226
Legislative Building
Regina, Saskatchewan
S4S 0B3

Dear Mr. President:

We have the honour to submit to you the Final Report of the Barber Commission on SaskEnergy.

We were appointed on May 9th, 1989 by Ministerial Order issued pursuant to section 74.2 of The Legislative Assembly and Executive Council Act.

We have completed our investigation into the proposed sale of the Saskatchewan Energy Corporation as directed by our Terms of Reference. In accordance with the Ministerial Order, we now deliver to you a report of our findings and conclusions, together with a transcript of the public hearings and briefs filed thereat.

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EXECUTIVE SUMMARY

In the Spring of 1989 the Government of Saskatchewan initiated a proposal to transfer to the private sector equity ownership in SaskEnergy, the Crown owned natural gas utility. The Commission on SaskEnergy Public Participation was established to review the enabling legislation and report upon its probable effects in certain designated areas, including control of the utility, impact upon rates, both gas and electrical, and such economic benefits as might flow from the proposed privatization.

The Commission interpreted its mandate as a direction to inform the public debate regarding the issues surrounding the SaskEnergy proposal, and to provide a forum to examine those concerns expressed by interested groups and individuals. The Commission has attempted to make a full and complete assessment of the likely impacts of the proposed privatization, but has not attempted to resolve the basic question of the future of SaskEnergy. A summary of the Commission's major findings follows.

SaskPower

The Commission learned that SaskPower has accumulated an unhealthy level of debt and that a major thrust of the proposal respecting SaskEnergy is to bring about a substantial reduction in that debt. Further, the transfer to SaskEnergy of the natural gas assets of SaskPower at their appraised value creates a $227 million mark-up of those assets above the book value. Realization of this gain would bring about an appreciable improvement in the debt:equity ratio of SaskPower. These features would contribute markedly to SaskPower's ability to maintain existing electrical rates and should minimize future rate increases. The debt question is one of two main issues identified by the Commission, the other being potential for diversification.

Control

Considerable concern was expressed to the Commission respecting the perception that control of SaskEnergy would be lost by the public.

The Commission concludes that these concerns are met by the provisions of the proposed The Saskatchewan Energy Corporation Act, which are designed to prevent control of the utility being lost to Saskatchewan. Similar provisions in other jurisdictions have proved effective in protecting against diminished control.

The Commission concludes that the Corporation would remain subject to the regulatory authority of the provincial government through the normal legislative process.

Rate and Other Impacts

Saskatchewan consumers enjoy the second lowest natural gas rates in Canada, but electrical rates are among the nation's highest. The Commission directed much of its attention and analysis to the probable impact upon these rates, now and in the future, of the proposed privatization of SaskEnergy.

Because of the significant reduction in the debt load of SaskPower, the Commission is of the view that the proposal would have a beneficial impact upon the rates charged to users of electrical power in Saskatchewan, both in the short and long term.

As a private sector corporation SaskEnergy would be faced with certain additional costs such as taxes, franchise fees and dividends to shareholders. However, the efficiency of the utility currently is such that those additional costs could be absorbed without an increase in natural gas rates. Similarly, although the proposal would result in a duplication of some services between SaskEnergy and SaskPower, the Commission is of the view that the costs of such duplication would not significantly affect the rates of either utility.

Completion of the Saskatchewan Natural Gas Distribution Program would not be adversely affected by the proposed privatization of SaskEnergy.

Municipalities

The SaskEnergy proposal would replace the current system whereby the provincial gas utility makes payments to municipalities by way of gas grants and grants-in-lieu of taxes. The Commission was advised that a privatized SaskEnergy would pay municipalities a franchise fee of 5% of gas revenues generated within the municipality. In addition, the utility would become subject to the payment of municipal property taxes upon its transmission facilities and commercial property.

The Commission has determined that the net effect of the proposed franchise fee and municipal taxation would, at current levels, result in increased revenue to Saskatchewan municipalities of approximately $10 million. A number of municipalities not presently receiving grants would be included in the revenue scheme proposed.

The Commission concludes that the proposed revenue arrangement with Saskatchewan municipalities is appropriate, but recommends that the franchise fee, which is not incorporated in the proposed legislation, be so included. The Commission also recommends that certain jurisdictional issues still outstanding between SaskEnergy and municipalities should be promptly addressed regardless of the outcome of the privatization proposal.

Regulatory Safeguards

The proposal before the Commission would convert SaskEnergy from a non-regulated Crown corporation to a regulated private sector corporation. The Commission paid particular attention to, and commissioned a specific analysis of, the regulatory arrangements proposed for a privatized SaskEnergy. Regulation is imperative if SaskEnergy is to become investor owned.

Two different regulatory arrangements are proposed for the privatized SaskEnergy, one to oversee the gathering and transportation functions performed by the subsidiary TransGas, and the other to regulate distribution as carried out by another subsidiary, Provincial Gas.

The Commission concludes that the regulatory system proposed for TransGas is consistent with gas transmission regulation in other jurisdictions and would provide a proper and effective method for regulating this service. The Commission has recommended certain amendments which it feels would strengthen that regulatory structure.

The proposed regulatory mechanism for Provincial Gas is innovative and streamlined. Given the limited history of rate regulation in Saskatchewan, the Commission is of the view that such streamlining may result in a misunderstanding of the regulatory process and its application. The Commission concludes that significant modification to the proposed mechanism is required.

Share Purchase Incentives and Economic Programs

The SaskEnergy privatization proposal contains a number of features designed to assist Saskatchewan residents in the purchase of equity shares. The proposal also contains a suggested economic development program to be administered by SaskPower.

Any proposed equity share issue should be acquired and retained by as many Saskatchewan residents as possible. To this end, the "Put Option" which would effectively guarantee the initial share purchase price for Saskatchewan residents, and the proposed deferred payment and employee share purchase plans are, in the Commission's view, appropriate to the overall scheme. Other purchase incentive features, such as the gas account dividend would, in the Commission's view, be costly to administer and provide minimal overall benefit.

The Commission concludes that, if the SaskEnergy privatization proposal is implemented, all funds which flow to SaskPower should be utilized in debt reduction. Programs such as the suggested 50% reduction of electrical accounts to curling and skating rinks are socially desirable, but if undertaken at all, should not be undertaken in such a way as to distort the real electrical rates borne by customers of the utility.

It is the view of the Commission that the most effective method of encouraging economic development and diversification in Saskatchewan is by offering the most competitive utility rates possible.

Economic Diversification

The potential for SaskEnergy to diversify as a private sector corporation and the likely consequent benefits to the provincial economy, formed one of the two most central features of the privatization proposal, the other being impact of debt repayment.

In a rapidly globalizing world economy a gas utility enjoys significant opportunities in related gas based industries. Given the speed of modern decision making, instantaneous access to information and the sophistication and flexibility of today's capital markets, any enterprise wishing to seize upon such opportunities must be able to respond promptly and without regard to political constraints. To take advantage of opportunities, both within and outside Saskatchewan, a diversified SaskEnergy has greater likelihood of success if it is not required to compete for government attention.

The Commission concludes that a privatized SaskEnergy would be a sound vehicle for the undertaking of diversification and, further, that such an entity has a greater chance of diversification success than would a Crown corporation.

Other Issues

A number of other issues and concerns were raised before the Commission, either by its terms of reference or by way of briefs and submissions. Upon examination the Commission has concluded that these issues would be unaffected by the privatization proposal and can be considered materially "neutral" to the question of ownership of SaskEnergy. For instance:

- Regulation and control of the production and sale of Saskatchewan natural gas. These matters are presently under the authority of Saskatchewan Energy and Mines and the SaskEnergy privatization proposal would have no effect upon this situation.

- The energy provisions of the Free Trade Agreement will continue to apply to both Canada and Saskatchewan, regardless the ownership of SaskEnergy.

- Although the Free Trade Agreement contains certain restrictions regarding ownership, it also includes provisions which permit federal and provincial governments to impose ownership restrictions on Crown corporations being sold into the private sector.

Summary

Having conducted its hearings and examined the briefs submitted to it, the Commission concludes that the proposed privatization of SaskEnergy should be examined in the light of two main issues:

1. The current debt level in SaskPower and the impact of the proposed share offering on the debt of SaskPower and its guarantor, the Government of Saskatchewan.

2. The potential for diversification of the company itself, and the resulting potential benefits to the provincial economy.

The proposal to privatize SaskEnergy has the potential to accomplish both a significant reduction in SaskPower's debt and to contribute to diversification of the company itself and the provincial economy.

CHAPTER I - INTRODUCTION

1.1 Preamble

In April, 1989, the Government of Saskatchewan proposed to "privatize" or transfer to the private sector equity ownership of SaskEnergy, a public utility company which transmits and distributes natural gas to residential, commercial and industrial consumers throughout the Province of Saskatchewan. The proposal provoked a storm of controversy which led to the creation of this Commission.

The government placed its enabling legislation respecting the privatization of SaskEnergy before the Saskatchewan Legislative Assembly on April 21, 1989. Without floor debate the Official Opposition walked out of the assembly effectively suspending further business of the assembly. The divisional bells rang for seventeen days from April 21st to May 8th, 1989.

The impasse was resolved when the government agreed to appoint an advisory committee to inquire into and report upon the proposed public share offering in SaskEnergy Corporation and to withdraw the enabling legislation until the Commission had completed its work.

1.2 The Appointment of the Commission

The Commission on SaskEnergy Public Participation was created on May 9th, 1989 by ministerial order issued pursuant to Section 74.2 of The Legislative Assembly and Executive Council Act. The Commission was to operate on the following Terms and Conditions:

a) Inquire into and report in accordance with the Terms of Reference[1];

b) Hold public hearings and consultations as the Commission saw fit throughout Saskatchewan; and

c) Complete and submit its final report to the President of the Executive Council by October 1, 1989.

The Commission consists of three members: The Chairman, Dr. Lloyd I. Barber O.C., President of the University of Regina, who has participated with numerous boards, tribunals and commissions and served as Federal Indian Claims Commissioner; Mr. Kenneth D. Sarsons, retired executive who was long associated with Saskatchewan Wheat Pool and its subsidiaries; and Ms. Kathryn J. Ford, lawyer with the Robertson Stromberg law firm and an active community worker. The Commission has come to be known as the Barber Commission.

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[1] See Appendix A3 for Terms of Reference.

1.3 The Conduct of the Inquiry

The Commission determined that its function was to elicit and receive as much information as feasible, commission independent research and studies where necessary, and evaluate and assess all such material. The Commission hopes that its report and findings will provide a factual backdrop to the philosophical and political public debate over what had already proven to be a very sensitive provincial issue.

From the outset, the Commission determined that all aspects of its inquiry would be completely open to all participants, the media and the public. Accordingly, all the Commission hearings were conducted in public and all of the submissions, documents and transcripts of the hearings, including reports ordered by the Commission, were available to the media and to the public.

In the course of fulfilling its mandate, the Commission undertook the following courses of action:

i) May 9th - 31st, 1989 - Commission engaged staff, adopted its Rules of Procedure, secured offices and arranged the proposed schedule of hearings.

ii) June 1st, 1989 - the Commission held a news conference at which its members were introduced and its Terms of Reference, Rules of Procedure and anticipated hearing locations were announced.

iii) June 5th - 30th - letters were forwarded to a broad range of companies, co-operatives, labour organizations and associations, seeking their participation in the hearing process. A total of 302 potential participants were thus contacted.

iv) June 5th - 10th - advertisements were placed in Saskatchewan weekly and daily newspapers inviting inquiries and participation.

v) July 10th - the submissions of SaskPower and SaskEnergy in support of the proposed public share offering were received and promptly delivered to those other declared participants who had requested them.

vi) July 14th - initial date for submission of written briefs. (Extensions were granted on request and, in fact, no written briefs were refused by the Commission throughout its entire hearing process.)

vii) July 26th - 27th - the Commission, sitting in Regina, received SaskPower's and SaskEnergy's initial oral presentation in support of their briefs filed earlier.

viii) August 3rd - September 1st - the Commission conducted public hearings in eight different Saskatchewan communities ranging over thirteen days. A total of 133 oral presentations were received.

ix) September 18th, 19th - 20th - recall of SaskEnergy and SaskPower officers to respond to questions by Commission members and Counsel on specific issues raised during the public hearings as well as in the written briefs.

x) September 21st - October 31st - the Commission evaluated all of the information it had received, considered its findings and prepared its report.

There is no prescribed set of rules and procedures for inquiries of this kind. The procedures eventually adopted by the Commission were dictated by its Terms of Reference, the nature of the issue before it, and common sense. The Commission indicated its willingness and desire to accept written briefs from all interested parties. Apart from the rules of decorum and common courtesy, there were no formal rules governing the public hearings. Everyone who filed a written brief was invited to appear and discuss the issues in whatever way suited them best.

The Commission also retained the national accounting firm of Peat Marwick to advise and report on certain of the financial and regulatory matters.[2] In addition, William Houston of the Fraser Beatty law firm in Ottawa, an acknowledged expert in regulatory matters, advised the Commission and questioned officials of SaskEnergy extensively on matters pertaining to the proposed regulatory scheme.

Recognizing that positions on this vital public issue would be properly aired only if the issue was debated by all segments of the Saskatchewan community, the Commission was careful to inform the public of its hearings both by advertisement and direct solicitation. The Commission believed that the issues before it were of sufficient complexity that written submissions were essential. To maintain decorum and orderliness, members of the public were not expected to address the Commission unless they had filed a written brief.

The Commission records its gratitude for the public response to its work. The sincerity and integrity of the briefs received indicate a wide acceptance of the hearing procedures adopted by the Commission.

The members of the Commission entered upon their inquiry with open minds, determined to assess and evaluate objectively and free from extraneous influences the questions and the information placed before them. The Commission recognized that not all of its conclusions or recommendations would necessarily be accepted or acted upon, and its work would be only one segment of a larger and continuing public debate on public participation or privatization issues. Commission members have dedicated themselves to their responsibilities to the best of their collective abilities. They hope that their work, and this report, will accomplish the goal of contributing to an informed public debate.

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[2] See Appendix A - Rate Regulation Report, Appendix A10 - Analysis of Financial Impacts.

This report and the hearings preceding it would not have been possible in the short time available to the Commission without the dedication and competence of its staff, including Gary J. Drummond, Executive Secretary and Legal Counsel; Robert McDonald, Research Director; Thomas Dawson, Research Officer; and Christine Ste Marie, Secretary. In addition, the Commission acknowledges the important contribution made by the Peat Marwick accounting firm, William Houston with Fraser Beatty law firm in Ottawa, Strategy West which arranged for the facilities, Propp Court Reporting Services which transcribed all the oral presentations, and AV Production House, which installed and monitored the sound system.

CHAPTER II - HISTORY

The Saskatchewan Power Corporation (SaskPower), originally called the Saskatchewan Power Commission, was established more than 60 years ago to consolidate a large number of small electric utilities serving individual communities and municipalities. A single, province-wide electrical utility offered a number of advantages, including cheaper and wider distribution of electrical service.

Throughout its history, SaskPower has used debt as its single source of financing. General tax revenues of the province have not been used to fund the utility. The cost of capital has been charged to consumers of electricity and, more recently, natural gas.

SaskPower's first major post war initiative was the rural electrification of the province which took place between 1949 and 1961. During this period, approximately 90,000 km of electrical line were constructed and some 58,000 farms were added to the power distribution system.

In 1959, the construction of large thermal power plants commenced with the Queen Elizabeth Station at Saskatoon and at the Boundary Dam near Estevan. Lignite-fired generation at Boundary Dam and at Poplar River near Coronach have become the backbone of SaskPower's generation system. Hydro generation was added to SaskPower's capacity with the commissioning of Squaw Rapids, (now E. B. Campbell) on the Saskatchewan River in 1963, followed by installations at Coteau Creek on Lake Diefenbaker in 1967 and at Nipawin on the Saskatchewan River in 1986.

SaskPower's first tie-line was with Manitoba Hydro in 1960. Lines with Manitoba Hydro and Basin Electric in North Dakota in subsequent years fostered improved utilization of generating capacity for all three interconnected utilities. In 1988, an agreement was signed with Alberta Power Limited for an electrical tie between Alberta and Saskatchewan.

In the early 1950's, SaskPower was given a monopoly to supply natural gas to residents and industries within Saskatchewan. By the early 1960's, it was supplying natural gas to all provincial cities and most towns. In the early 1980's, a program was undertaken to extend the gas system to the rural areas, as the electrical system had been 30 years previously. This program will add another 35,000 customers to the gas service in the province when completed.

Full deregulation of the natural gas industry, which occurred in 1987, ended SaskPower's monopoly over the supply of natural gas in the province. Natural gas purchasers were able to negotiate directly with natural gas producers, and, in turn, Saskatchewan gas producers aggressively sought sales markets in other provinces and export markets in the United States. Additional gas transmission facilities were required to service these new markets. Deregulation resulted in a different customer base and a change in customer relationships.

As a reflection of this new reality, the gas division of SaskPower was restructured with the creation of SaskEnergy Corporation, a wholly owned subsidiary of SaskPower, in April of 1988. In June of 1988, SaskEnergy purchased all assets relating to the transmission and distribution of natural gas from SaskPower. The SaskPower assets were acquired at the appraised value of $653 million, with $625 million allotted for property, plant and equipment and current assets valued at $28 million. SaskEnergy does not own any gas producing properties; however, it does own and operate gas storage facilities and carries gas in inventory. The decision to separate the electrical and gas division into distinct corporate entities has generally been seen as a positive evolutionary step.

In the late 1970's and 1980's, SaskPower began to expand its electrical generation capacity and its transmission and distribution facilities to meet increasing demand for electricity. This required expansion came during a time of rising inflation and high interest rates. Electrical rates did not keep pace with the rapidly rising costs and the earnings of the corporation were inadequate to fund the required capital expenditures. As a result of the combination of economic factors and increased capital expenditures, the debt of the corporation soared, jumping from $543 million in 1976, to $1.1 billion in 1981, to $2.1 billion by 1986. The debt component of the electrical utility's capital structure had reached 99% in 1986 with forty two cents of every dollar of sales going towards paying interest on its debt. Contributing to the financial strain on SaskPower was the fact it continued to pay dividends to the provincial government until 1982[3]. These dividends amounted to $59 million from 1976 to 1981.

The deterioration in the financial structure of SaskPower and the increasing debt load, far above the debt:equity ratios of public utilities in other jurisdictions,[4] resulted in an inability to hold electrical rate increases in check and accordingly, electric rates increased dramatically,[5] so that Saskatchewan now has the second highest industrial electrical rates and the third highest residential rates in Canada.

A fiscal restraint program was undertaken in 1986. The program included rate increases of 7.5% per year from 1986 to 1988, staff reductions and wage freezes. The restraint program has reversed the financial deterioration of the corporation considerably, although SaskPower still has over $2 billion in debt. SaskPower is also faced with large capital expenditure requirements in the near future to replace aging equipment and meet new demand.

It is against this background that the proposal enabling a public share offering in SaskEnergy Corporation was put forward by the Government on April 21, 1989.

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[3] See Appendix A11 - Table IA for Schedule of Dividend Payments.

[4] See Appendix A11 - Table IIA for Comparison of Debt/Equity Ratios.

[5] See Appendix A11 - Table IIIA for Comparison of Electrical Rates.

CHAPTER III - PROPOSAL

3.1 Corporate Structure

In 1988, the natural gas division of SaskPower was separated from SaskPower and made into a separate subsidiary company, the Saskatchewan Energy Corporation (SaskEnergy). SaskEnergy was incorporated under The Business Corporations Act (Saskatchewan) on April 25, 1988, as a wholly owned subsidiary of SaskPower. SaskEnergy, in turn, wholly owns five subsidiary companies:[6] TransGas Limited (TransGas), Provincial Gas Limited (Provincial Gas), Bayhurst Gas Limited (Bayhurst), Many Island Pipe Lines (Canada) Limited, and Many Islands Natural Gas (Canada) Limited:

- TransGas is a transmission company which owns and operates gathering, treatment, compression, storage, and transmission facilities within Saskatchewan for the purposes of transporting natural gas.

- Provincial Gas is a distribution company responsible for the distribution of natural gas to most of Saskatchewan consumers, including residential, commercial and some industrial.

- Bayhurst Gas Limited owns an option to acquire from SaskPower a gross overriding royalty from petroleum and natural gas properties sold to Saskatchewan Oil and Gas Corporation (SaskOil).

- Many Island Pipe Lines owns certain natural gas compression and transmission facilities relating to the licensed transportation of natural gas from Alberta across the Saskatchewan border.

- Many Islands Natural Gas is wholly owned by Many Island Pipe Lines and its operation consists of one natural gas buy-sell agreement.

In June of 1988, SaskEnergy purchased the assets of the natural gas division from SaskPower for $653 million. This consisted of $625 million for the fixed assets of the natural gas division and $28 million for current assets. SaskEnergy assumed $33 million in liabilities which made the net value of the purchase $620 million. SaskPower also provided SaskEnergy with additional financing for capital expenditures in the amount of $167 million. As of May 31, 1989, SaskEnergy Corporation therefore owes SaskPower Corporation $787 million.

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[6] See Appendix A12 for Corporate Chart.

Payment to SaskPower was made with several debt notes with no fixed repayment period:

- $393 million bearing interest at 10 1/2%; and
- $394 million non-interest bearing notes.

3.2 Proposed Sale

The proposal in respect of SaskEnergy is to permit private ownership in the corporation through a share offering. SaskEnergy would retain a legislated monopoly on the transportation and distribution of natural gas within the province of Saskatchewan.

The rationale presented to the Commission by officials of SaskPower and SaskEnergy for the proposed public share offering, or "privatization", was as follows:

i) Proceeds from the sale would allow SaskPower to reduce its debt significantly thereby reducing its annual financing cost with the potential for an impact on power rates. This debt reduction would reduce the amount of debt guaranteed by the Government of Saskatchewan.

ii) SaskEnergy would gain access to capital markets unavailable to it as a Crown corporation.

iii) As a private corporation, SaskEnergy believes it would be able to respond more quickly to changes in the economy, the natural gas industry and new diversification opportunities.

3.3 Legislation

The proposed public share offering in SaskEnergy involves four pieces of legislation.

i) Bill 21, The Power Corporation Amendment Act.

This Act amends The Saskatchewan Power Corporation Act to remove the right from SaskPower to transport and distribute natural gas within the province.

ii) Bill 22, The Saskatchewan Energy Corporation Act.

SaskEnergy currently receives the right to transport and distribute natural gas in Saskatchewan from its parent, SaskPower. This Act would grant SaskEnergy the exclusive right to distribute and transport natural gas in the Province of Saskatchewan. The Act sets out restrictions on ownership of SaskEnergy, a requirement for Head Office location in Saskatchewan and deals with the appointment and constitution of the board of directors. The Act further deals with the regulatory framework for TransGas, the requirement for a 15 year secure supply of natural gas, and the authority of Lieutenant Governor in Council to direct completion of the rural gas distribution program.

iii) Bill 23, The Distribution of Gas Rate Regulation Act.

This Act sets out the duties, restrictions, rights and the regulatory system of SaskEnergy's natural gas distribution subsidiary, Provincial Gas.

iv) Bill 24, The Public Utility Companies Income Tax Rebates Act.

The federal Public Utilities Income Tax Transfer Act (PUITTA) rebates to the Provincial Government 95 percent of the federal income tax paid by the utility. Under Bill 24, this federal rebate, and 100 percent of the provincial income tax paid by the utility must be rebated back to the utility which in turn must rebate it to its customers.

3.4 Financing of Proposal

Before being transferred to SaskEnergy, the assets of the natural gas division were appraised by independent professionals. This appraisal was based on the value of the assets for their continued use. The assets were purchased for the appraised value of $625 million, which represented a $227 million mark up from the book value of $398 million.[7]

At May 31, 1989, SaskEnergy owed SaskPower a total of $787 million, being the aggregate of $620 million for acquisition of the natural gas division's fixed assets, and $167 million advance from SaskPower between June 31, 1988 to May 31, 1989 for capital expenditures.

The proposed public share offering calls for SaskEnergy to issue approximately $300 million in common equity shares and to raise approximately $487 million in debt. Of this $300 million equity, approximately 50% would be offered for sale to Saskatchewan residents, with the remaining equity shares being retained by SaskPower.

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[7] SaskPower's recorded book value at June 1, 1988 (less customer contributions).

Under this proposal, the $787 million owing by SaskEnergy would be repaid to SaskPower as follows:

i)	Proceeds from public share offering (Class A shares) -	$150 million[8]
ii)	Equity shares of SaskEnergy retained by SaskPower (Class B shares) -	$150 million
iii)	Proceeds of conventional borrowing by SaskEnergy -	$487 million[9]
		$787 million[10]

The net effect on SaskPower would be the receipt of approximately $637 million in cash and $150 million in equity shares of SaskEnergy, such shares to be fully participating as to ordinary dividends paid by SaskEnergy. The $637 million cash received by SaskPower would be used to reduce existing debt and fund other programs contained in the proposal. Under this arrangement, SaskPower would realize the full benefit of the $227 million mark-up from book value to appraised value of its natural gas assets.

The reduction in debt of SaskPower would have a beneficial effect on the Provincial Treasury. Since all Crown corporations borrow money using the provincial government's guarantee of repayment, lenders consider debt owed by Crown corporations as being a debt obligation of the provincial government. It follows that, if SaskPower were to pay down its debt, this would also mean a reduction in the amount of debt guaranteed by the provincial government.

3.5 Equity Shares to be Sold

The proposal calls for the creation of two classes of shares in SaskEnergy, Class A common shares and Class B common shares. The Class A shares would be available only to residents of Saskatchewan and would have a number of incentives and privileges attached to them. The Class B shares would be equivalent to the Class A shares but without any privileges or incentives.

The special incentives which attach to the Class A common shares would be for the benefit of the first holders of such shares only. Once sold or transferred, the Class A common shares would automatically convert to Class B common shares and the privileges and incentives would no longer apply.

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[8] $150 million is an estimate. The actual value will depend upon issue price and the number of shares sold to the public and the number retained by SaskPower.

[9] SaskEnergy would borrow funds in the capital markets to repay debt owed to SaskPower, essentially replacing debt owed to SaskPower with debt owed to bondholders and financial institutions.

[10] Dollar values are estimates and will vary over time as SaskEnergy's operations are ongoing.

The Class B shares would be listed and trade on the Toronto and Montreal stock exchanges. No such listing or trading would be available to the Class A shares since any sale or trade converts them automatically to Class B shares. The shares retained by SaskPower would be Class B shares and could be traded by SaskPower at its discretion. Both the Class A shares and the Class B shares would be entitled to receive dividends out of the earnings of the corporation. No guarantee exists that a dividend would be declared or paid.

The proposal would make the Class A shares available to Saskatchewan residents from investment dealers, banks, credit unions, insurance agents, trust companies and SaskPower/SaskEnergy offices. A maximum allotment of $10,000 of Class A shares per individual would apply.

The Class A shares would carry several special privileges and incentives. The initial purchaser would be entitled after, five years, to sell them back at the initial issue price. This becomes a form of guarantee.

The Class A shares would also carry a "gas account dividend". The dividend is expected to be a percentage of the initial share price. The percentage has not yet been determined. The gas account dividend, which would be dividend income to the shareholder, may be applied to the shareholder's gas bill if he or she is a customer of SaskEnergy. If he or she is not a customer, or if the shares are held in a registered retirement savings plan, the dividend would be paid in cash.

Saskatchewan residents would be able to finance their purchase of Class A SaskEnergy shares under a deferred payment plan with a down payment of 25% and the balance, including interest, payable in monthly instalments over five years.

3.6 Restrictions on Voting, Ownership, Directors, and Location of a Privately Owned SaskEnergy

The proposed Saskatchewan Energy Corporation Act includes a number of provisions and restrictions on the ownership of voting shares and on the operation of SaskEnergy. Share ownership would be restricted to Canadian citizens and residents. No one single shareholder or associated group of shareholders would be entitled to own more than eight per cent of all issued shares.[11]

The proposed Act would require that the head office of SaskEnergy Corporation remain in

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[11] See Section 4.1 of this report for details of restrictions.

Saskatchewan, that all directors of the corporation be Canadian citizens and that at least two-thirds of the board of directors be Saskatchewan residents.[12]

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[12] See Section 4.1 of this report for details of operational requirements.

CHAPTER IV - CONTROL OF A PUBLIC UTILITY IN THE EVENT OF PRIVATE OWNERSHIP

The Commission heard many briefs which expressed concern over the potential loss of control of SaskEnergy if the sale of its shares to the public were to proceed.

The following is a review of various controls, legislative or otherwise, which would exist in the event the proposed share offering proceeds.

4.1 Specific Legislative Control

In summary, the controls proposed for a shareholder-owned SaskEnergy, as set out in The Saskatchewan Energy Corporation Act, are as follows:

i) SaskEnergy may not change its name other than by regulation of the Lieutenant Governor in Council.

ii) SaskEnergy may not dispose of all or substantially all of its property and may not apply for continuance in another jurisdiction.

iii) The head office of SaskEnergy must be in Saskatchewan.

iv) Directors must be Canadian citizens and qualify under The Business Corporations Act (Saskatchewan). At least two-thirds of the directors must be residents of the province.

v) The Government of Saskatchewan may appoint to the board of directors a proportion of the total board equal to the proportion of the total issued voting shares which the government holds.

vi) Holders of voting shares must be Canadian citizens or residents of Canada. No one person or group of associated persons may hold more than 8% of total issued and outstanding voting shares. (This latter restriction would not apply to the government itself, or an agent of the government, such as SaskPower.)

The penalties applicable in the event of contravention of the ownership limits include loss of dividends, loss of voting rights, redemption of shares and judicial remedies.

The Commission, having reviewed the legislation and the representations made to it, finds that the legislative controls on the proposed private company are reasonable and adequate. They are similar to legislative controls governing other industries in Canadian jurisdictions where similar restrictions have proven effective in meeting the desired objectives.

4.2 Other Legislation

If the proposed "privatization" of SaskEnergy is implemented, the corporation, like any other business corporation in the province, would remain subject to the environmental protection laws of the province, the labour laws of the province, and all other legislation which regulates the conduct of business enterprises. It was suggested to the Commission that government may be in a serious conflict of interest when it is both a player on the economic field and the referee of the game, as is the case when government engages in economic activity through a Crown corporation. There may be a tendency for government not to regulate itself as stringently when it is one of the players. As well, there is a great temptation to change the rules in mid-game, causing hardship and disadvantage to the other players.

The Commission concludes that there would be no loss of ability on the part of the government to exercise regulatory control of SaskEnergy through the normal legislative processes in the event SaskEnergy became shareholder owned.

4.3 Rate Regulation

The proposal contained in the draft legislation studied by the Commission would effectively take SaskEnergy from the status of a non-regulated Crown corporation to a regulated privately owned corporation. Utility companies in most jurisdictions are granted a monopoly over the franchise area served because it is cheaper for a single company (or Crown corporation) to develop the infrastructure needed to serve customers. Competition, thus, does not provide the usual advantages of cost reduction.

Since normal competitive safeguards are not present under a monopoly utility situation, some form of regulation is necessary to ensure that consumers are not overcharged for a service which they can only purchase from a single supplier, while also ensuring an environment in which the utility will be financially viable.

The goals of regulation of a utility are to achieve a fair and reasonable balance among the following competing interests:

- the utility;
- the consumers of the service;
- investors and lenders of funds to the utility; and
- public policy interests of the government.

While all parties have an interest in maintaining the viability of the utility, each party has specific interests which they wish served. The role of regulation is to strike a balance between these interests by ensuring that rates charged for the service are reasonable, just, fair and non-discriminatory among the different classes of users. The role of government is to provide the legislative framework which allows for effective rate regulation.

The Commission concludes that the ability of the government to legislate and thereby control the rate regulatory mechanisms and processes is in no way impaired by the proposed public share offering.

4.4 Security of Supply

The Commission heard from several presenters who were concerned that private ownership in SaskEnergy would limit the security of supply of natural gas in the future.

Until the early 1980's, the Government of Saskatchewan followed a policy of requiring Saskatchewan produced gas to be sold only to SaskPower, with SaskPower being the sole transporter and distributor of Saskatchewan produced natural gas. Given this limited market and fixed low prices, there was minimal development of natural gas reserves within the province. Approximately two-thirds of the gas consumed in Saskatchewan was purchased from Alberta.

In 1983, government policy was changed to encourage development of the natural gas industry within Saskatchewan. The price paid for Saskatchewan produced natural gas by SaskPower was increased and a reduction in Alberta gas purchases was negotiated to allow for substitution of Saskatchewan produced gas for Alberta gas. In 1985, a goal was established to achieve self-sufficiency in natural gas use by the early 1990's. This goal was pursued through higher regulated natural gas prices, a revised royalty system for natural gas and greater permitted access to markets. The policy also allowed direct purchases of natural gas used as feedstock and provided a new export policy. This export policy allowed up to 30 billion cubic feet for export per year over the following five years, provided such producers undertook to explore and develop new reserves in Saskatchewan.

In October of 1985, Canada, Saskatchewan, Alberta, and British Columbia signed the Agreement on Natural Gas Markets and Prices to deregulate the interprovincial system for pricing and selling gas. Saskatchewan pursued deregulation in two phases. Under phase one, government regulation of prices was eliminated and a new royalty tax system for gas production was introduced. Phase two allowed direct sales of gas and established a policy on security of supply and the exporting of natural gas. Direct sales provided gas consumers with the option of buying gas directly from producers, with the gas division of SaskPower simply transporting the gas.

Under the 1985 policy, Cabinet directed SaskPower, and later SaskEnergy, to maintain, either under contract or through reserve ownership, a rolling supply of gas for its full service customers equal to 15 years of their demand at current consumption levels. Under the proposed Saskatchewan Energy Corporation Act, this directive given by Cabinet would become a legislated requirement. Gas users buying directly from producers assume responsibility for providing for their own security of supply through commercial arrangements. The provincial government assumes no responsibility for the security of supply of out-of-province interests.

The Commission concludes that security of supply is not affected by the proposed legislation.

The provincial government requires any producer wishing to export gas produced in Saskatchewan to hold a "removal permit" before natural gas is produced for out-of-province sales. Removal permits are granted by the Minister of Saskatchewan Energy and Mines. This process allows the government to monitor the sale of natural gas for supply, security and royalty purposes. Saskatchewan Energy and Mines determines the amount of natural gas reserves and the total volume of committed sales under contract on an annual basis. The difference between total net reserves and committed sales gives the amount of gas available for new sales, both within Saskatchewan and for out-of-province sales. Under the gas permit process, Saskatchewan Energy and Mines ensures that new sales do not interfere with existing sale commitments to Provincial Gas, Saskatchewan direct sales customers, and existing out-of-province purchasers.

The Commission heard submissions from a number of groups and individuals expressing concern over the ability of the Government of Saskatchewan to control and manage the production and export of natural gas under the proposed legislation. There are two important considerations relating to this issue. First, the production and sale of natural gas produced within Saskatchewan is regulated by Saskatchewan Energy and Mines. Secondly, although SaskEnergy would have a mandated monopoly to transport and distribute natural gas, all sales of natural gas in which SaskEnergy acts as transporter would still be regulated by Saskatchewan Energy and Mines. The proposed legislation makes no change to this regulatory regime.

The Commission therefore concludes that the ability to control and regulate the production and sale of natural gas produced within Saskatchewan will be unaffected by the proposed legislation.

At the present time, neither SaskEnergy nor its subsidiaries own natural gas reserves for production. If, in the future, SaskEnergy or its subsidiaries were to acquire reserves, such reserves would be subject to the same regulation as current producers. Therefore, the provincial government's ability to control the production and sale of natural gas would be unchanged.

During its hearings, the Commission heard questions and concerns raised about the security of supply of natural gas under the Free Trade Agreement signed with the United States. As a result of these concerns, the Commission sought the opinions of a number of people with expertise and reviewed reference material available on the Free Trade Agreement. A brief summary of the energy provisions of the Free Trade Agreement is given below.

> "... Canada has eliminated export taxes and other charges such as previously existed under the National Energy Program, and cannot re-impose them unless they are also imposed on supplies destined for the domestic markets. As well, Canada cannot impose a higher price on supplies to export markets

> than the price charged for supplies to domestic markets. Nevertheless, the export price must recover the cost of production and transmission and must not be lower than the price to Canadian customers for comparable service in the adjacent markets.
>
> The Agreement does not impose an absolute obligation on Canada to sell energy to the U.S. in times of shortage or otherwise. Rather, in times of shortage, U.S. buyers are entitled to buy the same proportion of Canadian supply that they had been buying over the previous 36 month period for the duration of their contractual arrangements. Thereafter, U.S. buyers have the right to bid against Canadians in open markets for a certain proportion of supplies. Canadian export restrictions would otherwise be fully applicable to exports in times of shortage."[13]

These provisions of the Free Trade Agreement apply to all suppliers of natural gas to the United States. SaskEnergy does not produce natural gas or own any natural gas properties, but simply transports natural gas (some of which could be to meet U.S. commitments). The destination of the gas is a condition of the contract between the supplier and the consumer. SaskEnergy transports the gas from the producer to the consumer and charges a tariff for doing so. The volume of natural gas produced within the province and where it is sold is regulated by Saskatchewan Energy and Mines.

The ownership of SaskEnergy would not alter in any way the obligations and provisions as set out under the Free Trade Agreement or the regulatory control of Saskatchewan Energy and Mines. The Commission concludes that the energy supply provisions in the Free Trade Agreement would have no impact on operations of, nor impose any new requirements or restrictions on, SaskEnergy or its subsidiary TransGas, whether Crown or shareholder owned.

Another issue raised in the briefs submitted to the Commission concerned the Free Trade Agreement as it would relate if SaskEnergy or one of its subsidiary companies became a producer of natural gas. As a producer, SaskEnergy would be subject to the regulation of Saskatchewan Energy and Mines as are all other producers. If SaskEnergy produced natural gas for export to the United States, it would be subject to the energy provisions of the Free Trade Agreement consistent with all other producers who sell to the United States. Both of these conditions would apply to SaskEnergy regardless of ownership.

The Commission therefore concludes that ownership of SaskEnergy does not change the impact of regulatory conditions and responsibilities on SaskEnergy should it choose to produce and sell natural gas.

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[13] Smith, Lyons, Torrance, Stevenson & Mayer: Barristers & Solicitors, A Guide to Canada - United States Free Trade Agreement, page 10; August 1, 1989.

4.5 Comparison of Shareholder Control of a Private Corporation vs. Voter Control of a Crown Corporation

It is anticipated by SaskEnergy officials that an initial share offering would, given the special attributes of the Class A shares, be sufficiently attractive that the shares would be purchased by a broad base of residents of the Province. Additionally, some 40-60% of the voting shares would be held by SaskPower.

Individuals familiar with Nova Corporation of Alberta, Alberta Energy Corporation, IPSCO, SaskOil and Westbridge contributed their experiences to the Commission about the influence of local shareholders on company operations and were consistent in the following views:

i) Having the head office of the Corporation in the province where so many shareholders reside has made the management and employees of the company particularly sensitive to input from shareholders.

ii) Management, living in the shareholders' community, is more sensitive to local issues and concerns and, in turn, the company's culture, style, and interest is shaped by the community in which it operates.

iii) These companies have looked to their own jurisdictions first to provide opportunities for employment, investment and growth.

iv) These companies have endeavoured to be good corporate citizens by contributing to the community in volunteer and charitable ways.

The experience of Alberta Energy Corporation (AEC) was of particular interest to the Commission. The Government of Alberta initially retained 50% of the shares, and gradually reduced its holdings to the current level of 35%. The Government of Alberta has consistently played the role of owner, but has played no role as manager or intervenor. The Alberta government has, the Commission was told, abstained from political influence on the management of the company and gave management the complete authority and responsibility for operating the company. The Alberta Government made an initial investment of $138 million when it formed AEC. Since then it has received $125 million from share sales. The current value of its remaining share holdings is $377 million. In addition to this, it has received dividends like all other shareholders. In its capacity as "government", Alberta has received royalty payments and has earned a return on certain provincial assets sold to the company. AEC has been a good investment for the Alberta Government and the people of Alberta.

It was repeatedly stressed to the Commission how important it has been to the success of Nova and AEC that the politicians and civil servants of their province have pursued a policy of non-interference in the management or operations of their companies.

The Commission heard the view that Crown ownership of a utility such as SaskEnergy as a Crown corporation permits better access and control by the average consumer (voter) than could be exercised on a privately owned company. This view is generally based on the belief that access to the political process and the power of the vote at election time is the ultimate protection against high natural gas and electrical rates, poor service and mismanagement.

The Commission concludes that, to succeed, business enterprises need freedom to act rapidly to changing economic circumstances. If there is any intention by the Government to influence unduly the management and operation of the company after the proposed privatization, then SaskEnergy might best be left as a Crown Corporation.

4.6 Implications of the Free Trade Agreement on Proposed Ownership Restrictions

The Commission heard several concerns raised over the impact of the Free Trade Agreement on the share ownership restrictions proposed for SaskEnergy. The Commission invited individuals with expertise on the Free Trade Agreement to clarify this matter.

Chapter 16 of the Free Trade Agreement deals with investment, including provisions relating to Crown Corporations. SaskEnergy is an existing Crown Corporation as defined under the Free Trade Agreement. If a government chooses to sell or privatize an existing Crown corporation, then under Article 1602(5), that government retains the right to introduce measures to restrict share ownership without violating any terms of the Free Trade Agreement. It may limit ownership to residents of a particular province or to residents of Canada. The government also has the ability to impose new restrictions as it sees fit.

The Free Trade Agreement provides that once a restriction is put in place, it cannot, subsequently, be made more restrictive. As the proposed legislation does not allow any foreign ownership, there is no way to make ownership more restrictive.

The Free Trade Agreement also does not restrict a provincial government from re-establishing a mandated utility as a Crown corporation. There is nothing in the Free Trade Agreement prohibiting the provincial government from reacquiring a privatized SaskEnergy, provided lawful and nondiscriminatory procedures are followed.

Another concern presented to the Commission was that, although no foreign ownership would be allowed in SaskEnergy initially, this could and would be changed in the future. The Commission fully recognises the provincial government has the ability to change legislation as it sees fit. If the proposed legislation were enacted and, at a later date, the government decided to allow foreign ownership in SaskEnergy, the above stated circumstances would still apply.

The Commission concludes that the Free Trade Agreement does not impair the provincial government's ability to impose restrictions on the ownership of SaskEnergy under the proposed legislation. The Commission further concludes that the impact of the Free Trade Agreement on SaskEnergy Corporation is the same whether the company is a Crown owned or investor owned shareholder corporation.

CHAPTER V - SPECIAL SHARE FEATURES AND ECONOMIC INCENTIVES

5.1 Equity Share Features

Under the privatization proposal, several special share features are proposed. SaskEnergy officials indicated these would ensure wide-spread distribution of the shares and, accordingly, participation by all sectors of the provincial population.

Put Option

The Class A shares would have a "put option" attached which would allow the initial purchaser to re-sell the shares at the issue price.

The put option would come into effect five years after the initial share issue and be exercisable only during a fixed period of time, probably a number of months. During this option period, the Crown Investment Corporation (CIC), on behalf of the Saskatchewan government, would purchase any shares offered to it at the initial issue price.

Any shares sold to CIC would be placed in a trust for subsequent sale. If there were a large number of shares to be sold, the sale would be controlled so as to not adversely affect the market share price. SaskEnergy would have the right to purchase any shares remaining in the trust and unsold after a specified time.

The Crown Investment Corporation would receive only nominal consideration for providing this put option.

The purpose of the put option would be to provide a guarantee of the initial investment for Saskatchewan residents, thus encouraging equity investment by Saskatchewan residents.

The Commission concludes that the put option would provide encouragement for a broad cross section of Saskatchewan residents to purchase and hold SaskEnergy shares.

Gas Account Dividend

The Class A shares would also carry the right to a Gas Account Dividend, the value of which would be a percentage of the initial share price. The amount of the dividend has not been set.

The dividend would be applied to the shareholder's gas bill. If the shareholder did not have a natural gas account against which to apply the dividend, or held the shares in an RRSP, the dividend would be paid in cash. Whether the shareholder receives the dividend in cash or as a credit towards a gas bill, it would be treated as dividend income for tax purposes.

The Commission concludes that this incentive could be costly to administer and its overall benefit is not clearly demonstrated.

Dividends Applied Against Gas Bill

Under the proposal, owners of Class A shares could choose to have all or a portion of ordinary dividends paid out to them applied as a credit to their gas billing account with SaskEnergy. This option is separate and distinct from the Gas Account Dividend.

The Commission concludes that this incentive may be costly to administer and its overall benefit is not clearly demonstrated.

Deferred Payment Plan

Under the proposal, purchasers of Class A shares may finance their purchase of shares under a deferred payment plan. The plan would require an initial payment of 25% of the purchase price, with the remainder being payable in equal instalments over 60 months. Purchasers using this plan would be charged interest on the outstanding balance.

The Commission concludes that this feature of the proposal might well be attractive to all residents and should encourage a wide distribution of shareholdings.

Employee Share Purchase Plan

Each employee of SaskEnergy and its subsidiaries would be issued a small number of shares at no cost. These gifted shares would be held in trust for a period of 12 months, after which the employee would be able to sell or transfer the shares.

SaskEnergy would also provide its employees with a matching offer plan which would allow them to purchase one Class B common share at $0.01 for each Class A share purchased. A limit would be set on maximum number of shares to be matched.

To assist employees in purchasing Class A shares, SaskEnergy would establish an employees' deferred financing plan under which the amount of the share purchase would be payable in 60 monthly payments with no interest to be charged for the first 12 months.

A certain number of Class A shares would be reserved for sale to the employees of SaskEnergy, SaskPower and their subsidiaries.

Employee share ownership plans are viewed very positively by other shareholder-owned companies and is not unique to a company undergoing change from a Crown corporation to a shareholder-owned corporation. Representations were made to the Commission that Employee Share Ownership Programs were beneficial to the company and its employees. It was seen as being advantageous for employees to have a stake in the success of the company.

The Commission concludes that the Employee Share Ownership Program is an appropriate feature if the privatization proceeds.

5.2 Economic Incentives

If this proposal proceeds, SaskPower would undertake a number of economic incentive programs.

- An economic diversification fund would be established to assist new industries and business which produce goods not currently produced in the province. $10 million per year for the next four years would be dedicated to this program.
- An electrical discount plan would be created. Each customer would earn a 10% discount on their monthly bill up to $100. The customers could choose to have a credit against their electrical bill or receive $100 worth of SaskEnergy shares, at the initial offering price. These shares would be Class B shares.
- A 50 percent reduction of electric bills would be granted to all curling and skating rinks in the province for four years.

The Commission recognizes the need for diversification within Saskatchewan and the diversification fund may be seen as one method of encouraging this. SaskPower has developed an extensive Buy Saskatchewan program which has been very successful. However, the primary purpose of the privatization proposal is to improve the financial condition of SaskPower.

The Commission believes that if the share sale proceeds, all funds received by SaskPower should go toward reducing its existing debt or future borrowing requirements.

While the electrical discount program is intended to encourage wide-spread ownership of SaskEnergy shares, the Commission believes such a program would discriminate between Saskatchewan residents who have electrical billing accounts and those who do not.

The Commission concludes that the electrical discount share purchase plan would not be productive. The share allotments created would be too small and the program would be difficult and costly to administer and would be discriminatory.

The Commission views the electrical discount proposed for skating and curling rinks as a worthy social goal. However, an electrical discount program for skating and curling rinks amounts to subsidization from all electrical consumers to the users of skating and curling rinks. Once such programs are undertaken, they are often difficult to terminate. Furthermore, this program would reduce the incentive for skating and curling rinks to take steps to reduce their consumption of electrical power. Also, this program would benefit one worthwhile activity over many others.

The Commission concludes that such social programs should be left in the domain of direct government support. Programs of this type should not be undertaken in such a way as to distort real rates to electrical consumers. If the proposal does go forward, at the very least this subsidy should decline over the proposed four year period. A declining subsidy would focus the attention on conservation.

General Conclusions on Incentives

In assessing these incentives, the Commission concludes that all proceeds from the sale of shares would be best utilized in reducing SaskPower's debt. The Commission also concludes that the best method of encouraging economic development and diversification is by offering the lowest electrical rates possible.

The Commission makes this conclusion with the realization that, if Saskatchewan is to have an industrial and manufacturing sector, it must export. Saskatchewan alone, with its small population and industrial base, cannot support the economies of scale required to compete not only outside the province, but with products coming into the province. Saskatchewan is at a disadvantage geographically for exporting. Any reduction in the cost of manufacturing, including energy costs, improves the competitive position of Saskatchewan companies. A dramatic example was presented to the Commission by IPSCO of Regina. Its brief stated that a five percent reduction in power costs would enable IPSCO to divert such savings to offset transportation costs and thereby extend its economic market area by some 400 to 500 miles. This would result in a six-fold increase in market population served.[14]

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[14] Page 16, IPSCO Inc. submission to Barber Commission.

CHAPTER VI - DIVERSIFICATION

The Terms of Reference directed the Commission to assess the proposal's potential for diversification of the provincial economy, SaskEnergy, and potential employment for Saskatchewan residents.

The need to diversify the Saskatchewan economy has long been recognized, but the best method to promote diversification has often been a contentious issue. Quantifying the potential of a future diversification initiative is difficult.

While the Commission considers the diversification potential, together with the debt reduction issue, central to the privatization proposal, it has found the diversification question difficult to measure. The Commission is not in a position to judge the strength or weakness of any particular individual diversification effort. Such projects must be examined on their own merits when they are undertaken and their success or failure will only be apparent subsequently. Examination of specific diversification proposals is also difficult because of the need for confidentiality in a competitive environment. For this reason, diversification proposals discussed before the Commission were of a general nature only.

Any potential for increased employment or diversification of the provincial economy as a result of this proposal must flow from the growth and diversification of SaskEnergy itself. Thus, the Commission has attempted to assess the diversification potential of SaskEnergy if privately owned.

Submissions made to the Commission in support of a public share offering in SaskEnergy suggested that there was considerable opportunity for a private sector company to grow and diversify. Examples include:

- oil and gas production/refinement;
- agricultural products and applications;
- petro chemicals;
- fertilizer manufacturing/distribution;
- compressed natural gas for motor vehicles; and
- cogeneration of electricity.

In addition, SaskEnergy management stated it was considering engineering services, expansion of its storage facilities for use by other companies, natural gas production, selected food processing, and extra-provincial pipelines and energy related projects as targets for diversification. SaskEnergy also cited its capacity to establish joint ventures with companies in need of technology and expertise relating to natural gas. It also believes that the competition engendered between electrical power and natural gas will provide further opportunities for growth and diversification.

Saskatchewan faces many obstacles in its efforts to diversify. Saskatchewan has a small population. Large scale manufacturing to serve only Saskatchewan becomes almost impossible. This means Saskatchewan must export if it is to have large scale production and manufacturing. Saskatchewan is at a geographical disadvantage compared to many other provinces. These conditions exist and must be faced by all companies, whether privately owned or government owned.

Although faced with the above noted impediments to development, Saskatchewan also has some important advantages. Among these are resources, such as natural gas. In a competitive economic environment, low energy costs are becoming increasingly important.

The Commission was able to find suitable private sector comparisons to SaskEnergy. While none exist in Saskatchewan, a number of Alberta firms operating in the same industry as SaskEnergy were invited to appear before the Commission. The Commission recognised these persons tended to portray their own companies in a favourable light. However, they provided valuable insight into the growth of their organizations, the future of the natural gas industry and their perceptions of the diversification prospects of an energy company like SaskEnergy.

In the presentations made to the Commission by the Alberta based energy companies, there was general consensus that:

i) Natural gas-utility based companies in other jurisdictions have successfully diversified and grown. The success rate is not 100% and some risks have been taken which were negative to share values.

ii) Establishing the head office, directors and share ownership within a jurisdiction has been successful in providing priority for development within that jurisdiction.

iii) Opportunities for diversification are not limited for the foreseeable future.

iv) The risk factors are real and must be prudently managed.

v) Energy based companies have a somewhat unique capacity to identify and exploit opportunities because of the importance of energy supply in most industrial development.

vi) Diversification opportunities are very difficult to bring to fruition for a Crown corporation because of the inherent exposure to political interference. The dominance of politically-motivated decisions vis-a-vis economically motivated decisions, the lack of access to financial tools such as equity and new financial instruments, the slowness of decision making in a political environment and the extra-territorial constraints faced by a Crown corporation were all cited as reasons for this difficulty.

vii) Energy-related companies have a natural opportunity to diversify by supplying equipment and technology for energy efficiency and conservation.

In assessing diversification potential, the Commission has attempted to look to the future and not simply the past. Diversification must be viewed in the light of trends facing Saskatchewan including globalization, international competition and the instantaneous movement of money and information. Saskatchewan cannot isolate itself from these trends whether it wants to or not. These global conditions will impact efforts to bring diversification to the province. The Alberta experience has been that diversification of a gas utility company is not only possible, but also has the potential of realizing major success.

Three major concerns were raised before the Commission in respect of the diversification issue. These were:

i) Could diversification projects be undertaken as easily by a Crown corporation?

ii) Is a utility such as SaskEnergy a suitable vehicle for diversification?

iii) Are there risks to the gas consumer as a result of diversification projects?

Technically a Crown corporation can undertake any operation it wishes provided it has the required authority and financial capacity. However, the Commission believes that, in reality, the avenues of diversification open to a Crown corporation are limited. The limitations facing a Crown corporation include: territorial restrictions, political restrictions, restrictions on access to capital, and the inability to make decisions quickly.

Provincial Crown corporations are limited, for the most part, to operating within the boundaries of their home province. While there may be nothing legally impeding a Crown corporation from operating in other provinces, residents of other provinces would no more welcome Crown corporations of Saskatchewan into their jurisdiction than would Saskatchewan residents welcome Crown corporations from other provinces into Saskatchewan. SaskEnergy as a Crown corporation is realistically limited to operating in Saskatchewan.

Crown corporations are owned by the government, run by the government and take direction from government. In turn governments receive praise, and often criticism, for their operation of Crown corporations. The overriding factor in a Crown corporation's decision making process is political, not economic or business related.

These limitations placed on Crown corporations are not unreasonable. Crown corporations are normally created to fulfill a specific, limited and frequently social objective or purpose. The limitations help to keep the corporation focused on those purposes. SaskEnergy, as a Crown corporation, presently operates under these same restrictions. However, these restrictions, by their very nature, limit the ability of any Crown corporation, including SaskEnergy, to diversify.

With respect to the second question, the decision to use SaskEnergy as a vehicle for diversification must necessarily be a political one. Investor owned utility companies in other provinces have diversified and continue to diversify outside of the utility business. Therefore, the use of a utility for diversification efforts is supported by successful experience and precedent.

The Commission acknowledges that SaskPower and SaskEnergy have already performed a useful role in diversification and expansion of service for the province. However, this role as a Crown corporation is largely accomplished and further diversification can be best achieved with new techniques.

With respect to the third issue, proper regulation and prudent corporate management should insulate consumers of natural gas from the risk inherent in non-utility related diversification projects. This would be the case, whether SaskEnergy were government owned or privately owned. Regulators in other jurisdictions have insisted upon the total separation of the regulated and non-regulated activities of such companies. Generally there are restrictions on the pledging of assets and cross guarantees by the regulated company.

The Commission concludes that a privatized SaskEnergy provides a sound basis for undertaking diversification opportunities, and further that a privatized SaskEnergy has a significantly greater chance of diversification success than would a Crown corporation.

The Commission concludes that the greatest impetus for diversification of the provincial economy is by providing the lowest commercial and industrial utility rates possible.

CHAPTER VII - THE SPECIFIC IMPACTS OF THE PROPOSED PUBLIC SHARE OFFERING

The Terms of Reference of the Commission specifically directed a consideration of the impact on consumers of natural gas, the impact on rates charged by SaskPower for electricity, the impact on the general operation of SaskPower, and the impact on municipalities. Consequently, the Commission received numerous briefs concerning the impact of the sale of shares in SaskEnergy on energy consumers in Saskatchewan. SaskPower suggested that the major thrust of this proposal is to reduce its debt and financing costs, which would allow it to restrict future rate increases. Therefore, the impact of this proposal on consumers of natural gas and electricity is of central significance in the assessment of the proposal.

7.1 The Impact on Consumers of Natural Gas

Currently, Saskatchewan consumers enjoy the second lowest rates for natural gas in Canada, next only to Alberta. Saskatchewan has major advantages in that it is not only a producer of natural gas but also has close proximity to and thus low transportation costs for natural gas imported from Alberta.

Annual Natural Gas Bill for Consumers in Canada (1989)[15]

City	Annual Bill
Calgary	$ 517
Regina	$ 612
Vancouver	$ 687
Winnipeg	$ 706
Toronto	$ 920
Montreal	$1,258

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[15] SaskEnergy brief, page 46, July, 1989.

i) The Impact on Rates

Several issues that would be expected to increase natural gas rates were raised in briefs presented to the Commission. More specifically, these issues were:

- the impact of proposed income tax payable by SaskEnergy as a private-sector corporation;
- the impact of the proposed franchise fees and municipal property taxes on transmission lines and commercial property; and
- the required return on investment to satisfy the demands of equity shareholders.

Currently, SaskPower and SaskEnergy are Crown Corporations and are not subject to corporate income tax. The concern was raised that the payment of income tax by SaskEnergy as a private sector corporation would result in an increase in natural gas rates. However, federal legislation, the Public Utility Income Tax Transfer Act (PUITTA), rebates to the province in which the utility operates 95 percent of the federal income tax paid by privately-owned public utility companies. Under the proposed Bill 24, The Public Utility Companies Income Tax Rebates Act, this federal rebate, as well as 100 percent of the provincial tax payable, would be transferred to SaskEnergy "for the benefit of the persons who are from time to time their customers in Saskatchewan".[16] Therefore, virtually all income tax payable by a shareholder owned utility company would be returned to the company and must be passed on to the consumer.

Government owned Crown corporations do not pay income tax and, because of this, the fixed assets of a Crown corporation are not depreciated for tax purposes as are assets of a private company. The federal Income Tax Act allows depreciation (Capital Cost Allowance or CCA) to be claimed as a business expense, thereby reducing taxable income. Since SaskEnergy has not been taxable in the past, it has never used this depreciation. If SaskEnergy were to become a private, taxable company, it would have enough annual depreciation on its assets to reduce taxable income to zero for a number of years (estimated to be nine to ten years).

The Commission, therefore, concludes that the impact from income taxes on the utility portion of a privately owned SaskEnergy would be minimal and would not affect rates charged to consumers.

As outlined in the section entitled Impact on Municipalities, under this proposal SaskEnergy would become subject to municipal property tax if SaskEnergy were privately owned. Property taxes for transmission lines and commercial property would have been approximately $10 million in 1988. This represents an added expense to the corporation and one which would flow through in the price charged to consumers of natural gas. Under this proposal, SaskEnergy officers have calculated there would not be an immediate increase in rates from this new cost, as current revenue of the corporation would absorb the taxes in the revenue formula proposed. However, future property tax increases would be passed through in rates charged to consumers.

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[16] See Section 5 of Proposed Bill 24.

The Commission concludes the payment of property tax is appropriate whether or not the proposal proceeds.

Many participants raised the issue of shareholders demanding a higher return than do bondholders. Shareholders expect this higher return to compensate them for the additional risk they have as a shareholder. The concern was that this additional cost associated with equity would be passed on to the consumer of natural gas through higher rates. With a privately owned utility, it is usually the regulator who decides what level of return may be earned on the equity portion of the utility's capital structure (as well as how much equity is allowed in the company). Currently, the average return on the equity of utility companies in Canada is about 13.5%. This return is a cost which is figured into the rates charged to consumers. The formula in The Distribution of Gas Rate Regulation Act sets out how the regulator is to arrive at the allowed return on equity for Provincial Gas. TransGas is not affected by the formula since it negotiates its rates directly with its customers. Current rates charged by Provincial Gas would not increase under the proposed formula as they are sufficient to absorb the additional cost without requiring an immediate increase in the rates. However, future changes in the allowed return on equity could increase or decrease the allowed revenue of Provincial Gas, which would affect rates charged to customers.

The Commission concludes that there would be no direct or immediate increase in natural gas rates resulting from a public share offering in SaskEnergy because the current level of profits earned by the corporation are sufficient to satisfy the demands of equity shareholders and maintain an acceptable debt:equity ratio.

ii) The Impact on Service

Views were expressed that the quality of service might deteriorate under private-sector ownership. It is normal for legislation or the regulator of a utility to control many of the conditions of service. The conditions under regulatory control typically include the obligations to provide service in the franchise area, customer contributions to provision of service, collections practices, and service discontinuation procedures, among others.

It was suggested to the Commission that service should improve as employees become shareholders and the natural gas utility competes with the electric utility. There was no persuasive argument presented to the Commission that a private-sector utility could provide better service than a Crown corporation, or vice versa. In the City of Lloydminster, where customers are served by both public and private sector utility companies, service was not an issue between the utilities.

The Commission concludes that there would be no noticeable change in the quality of service to the natural gas customers as a result of a public share offering in SaskEnergy, and that this issue is, accordingly, neutral to the proposal.

iii) The Impact on the Saskatchewan Natural Gas Distribution Program

Several participants expressed concern about the continuation of natural gas service into rural Saskatchewan. The Saskatchewan Natural Gas Distribution Program (SNGDP), or rural gasification program, was established to provide natural gas service to many areas in Saskatchewan not already receiving this service. The benefit to these consumers is lower costs for space heating and water heating, and potential additional farm uses. The program is currently over 80 percent complete, and is, accordingly, a mature system. Section 17(1)(b) of the proposed The Distribution of Gas Rate Regulation Act provides that the Gas Commissioner (regulator) shall approve an addition to the rate base made for the purposes of any gas distribution program that the Lieutenant Governor in Council directs the corporation to undertake. This provision would allow the government to direct SaskEnergy to complete the SNGDP with the capital costs going into the rate base. In addition, the Commission specifically requested and received written assurance from the officials of SaskEnergy that it is committed to completing the SNGDP according to schedule. As one of the functions of a public utility is to provide universal service in a franchise area, future expansions can be approved by the regulator, or the government may make direct subsidies toward the capital cost of such expansion of service.

Saskatchewan Natural Gas Distribution Program[17]

Year	Services	Capital Expenditures $ millions
1982-1988	29,855	$255.7
1989	1,909	$ 20.4
1990	1,989	$ 19.6
1991	1,636	$ 20.0
1992	1,704	$ 20.0

The Commission concludes that completion of the SNGDP would not be affected by the sale of shares in SaskEnergy. As well, under the proposed legislation, the government could direct SaskEnergy to undertake similar types of initiatives in the future. Presumably such projects would receive government subsidy.

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[17] Source: SaskEnergy.

7.2 The Impact on Consumers of Electricity

The Commission was presented with comparative information on electrical rates, suggesting that, while Saskatchewan consumers enjoy the second lowest natural gas rates in Canada, their electric rates are among the highest in Canada.

Monthly Electricity Bill for Residential[18] and Commercial[19] Consumers in Canada (1988)[20]

City	Residential	Commercial
Vancouver	$37.04	$377.82
Calgary	$32.48	$449.44
Regina	$42.69	$567.38
Winnipeg	$33.03	$345.15
Toronto	$38.29	$479.76
Montreal	$33.48	$402.74
Moncton	$44.32	$539.77
Halifax	$47.34	$589.92

As outlined earlier, in 1986 the electrical utility had an unacceptably high debt:equity ratio of 99:1, with 42 cents of every dollar of revenue required to pay interest on such debt.

SaskPower's financial situation has improved somewhat since 1986, partially due to debt reduction resulting from the sale of its gas producing assets to SaskOil. However, finance charges still represent the largest single expense for the electric utility. In 1988, finance charges were $204 million, representing 32 cents of every dollar of revenue. The electric rates in Saskatchewan are not competitive with the neighbouring provinces of Alberta and Manitoba.

Over the next ten years, in order to meet new demand and replace spent assets, SaskPower forecasts that it will be required to make capital investments of $3.4 billion.

It is the position of SaskPower that, if the electric utility is to manage its current debt load, undertake its projected capital expenditure program, and avoid dramatic rate increases, corrective measures must be undertaken. The proposed sale of shares in SaskEnergy is one proposal for dealing with this debt problem. An infusion of cash from the provincial government might be another.

If SaskEnergy were privatized as proposed, SaskPower would receive a cash injection of approximately $650 million. This would result from a "privatization" of a portion of SaskPower's debt.

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[18] 600 kw/h for residential.

[19] 6300 kw/h for commercial.

[20] Source: SaskPower Brief, Figures 5.3 and 5.4, page 13-14.

The Commission was concerned with SaskPower's ability to restrict rate increases and provide other economic incentives, while at the same time undertaking major capital expenditures without incurring similar financial problems in the future. As a result of this concern, the Commission engaged Peat Marwick to undertake an analysis of the impact of this proposal on SaskPower. More specifically, Peat Marwick was asked to determine whether or not SaskPower fairly represented the impact of the sale of SaskEnergy to the Commission.

The analysis by Peat Marwick[21] focused on all information presented to the Commission by SaskPower and SaskEnergy, as well as additional information provided to it by the affected corporations. The analysis also involved a review of the models and the assumptions contained therein used in preparation of SaskPower's pro forma financial statements.

The Commission requested Peat Marwick provide a report of its findings relating to the representations made by SaskPower and SaskEnergy. The Commission asked Peat Marwick to provide an analysis of the proposal in two forms, one which included the economic incentive plans and one in which all money realized went to the operations of SaskPower. Forecasts are given in the following tables on the impact on SaskPower, firstly without the sale of shares in SaskEnergy, secondly with sale and including economic incentive programs and, thirdly with the sale but without economic incentive programs. All forecasts made by Peat Marwick include the appropriate portion of the capital development program suggested by SaskPower.

Information submitted and reviewed by Peat Marwick indicates that by SaskPower reducing its debt, as a result of this proposal, finance costs would be reduced to approximately 19.2 cents per dollar of revenue by 1993, compared to an estimated 28.5 cents per dollar of revenue without the proposal. Without the financial incentive programs discussed earlier, finance charges would be reduced to 18.1 cents per dollar of revenue by 1993.

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[21] See Appendix A10.

Impact on SaskPower

Finance Charges as a Percentage of Revenue[22]

	1989	1990	1991	1992	1993
Without Sale of Shares (No Privatization)	27.8	26.6	26.1	28.14	28.5
With Sale of Shares including Economic Incentive Programs	25.7	21.4	19.3	20.3	19.2
With Sale of Shares excluding Economic Incentive Programs	25.7	20.4	18.3	19.3	18.1

In 1988 the electrical utility's capital structure contained approximately 95% debt, which had decreased from a high of 99% debt in 1986. In 1986 the gas producing properties of SaskPower were sold to SaskOil helping to reduce the portion of debt to its current 95%. In its recovery plan, SaskPower had set a goal of attaining a debt:equity ratio of 80:20 by 1991. Without the proposed privatization of SaskEnergy, SaskPower could approach its target of 80:20 (debt:equity) by 1993. With the sale of SaskEnergy, SaskPower could considerably improve on this goal in a short period of time. This would also place SaskPower more in line with utility companies in Alberta (which use approximately the same type of electrical generation mix).

Impact on SaskPower

Long-Term Debt as a Percentage of Total Capital[23]

	1989	1990	1991	1992	1993
Without Sale of Shares (No Privatization)	90.1	87.2	85.1	83.2	82.0
With Sale of Shares including Economic Incentive Programs	65.3	62.9	61.4	57.7	54.8
With Sale of Shares excluding Economic Incentive Programs	65.3	61.6	59.1	54.9	51.5

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[22] Source: Peat Marwick Report to the Barber Commission Appendix A10; Analysis of the Proposed SaskEnergy Share Offering on SaskPower Rates.

[23] Source: Peat Marwick Report to the Barber Commission Appendix A10; Analysis of the Proposed SaskEnergy Share Offering on SaskPower Rates.

Comparison of Long Term Debt as a Percentage of Total Capital for Selected Electric Utilities - 1988[24]

Utility	Generation	Debt as a % of Total Capital
Mainly Hydro Generation		
B. C. Hydro	96% Hydro, 4% Thermal	92.3
Hydro Quebec	96% Hydro, 4% Nuclear	73.8
Manitoba Hydro	94% Hydro, 6% Thermal	96.7
Mainly Coal Generation		
Trans Alta Utilities) Alberta Power)	96% Thermal, 4% Hydro	64.8
SaskPower	82% Thermal, 18% Hydro	94.6
Mainly Nuclear Generation		
Ontario Hydro	47% Nuclear, 27% Hydro 26% Thermal	82.6

In addition to an improved debt:equity ratio and a reduction in the percentage of revenue used to pay finance charges as outlined above, the Peat Marwick analysis indicates other net benefits to SaskPower for the period 1989-1993 resulting from public participation in SaskEnergy. Highlights of these benefits as displayed in the following tables are:

- a reduction in finance charges of $223 million with the economic incentive programs, or $248 million without the economic incentive programs;
- a reduction in required financing of $321 million with the economic incentive programs, or $427 million without the economic incentive programs;
- a reduction in the long term debt of Saskpower in 1993 of $718 million with the economic incentive programs, and $823 million without these programs; and
- an increase in net income of $410 million with the economic incentive programs, and $518 million without these programs.

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[24] Source: SaskPower Undertaking No. 5 from July 26, 1989.

IMPACT OF A PUBLIC SHARE OFFERING IN SASKENERGY ON SASKPOWER

Finance Charges for SaskPower ($ millions)

	1989	1990	1991	1992	1993
Without Sale of Shares (No Privatization)	192	192	196	226	244
With Sale of Shares including Economic Incentive Programs	185	154	148	169	171
With Sale of Shares excluding Economic Incentive Programs	185	152	143	161	161

Financing Requirements for SaskPower ($ millions)

	1989	1990	1991	1992	1993
Without Sale of Shares (No Privatization)	189	241	411	159	183
With Sale of Shares including Economic Incentive Programs	268	136	365	30	63
With Sale of Shares excluding Economic Incentive Programs	268	106	334	12	36

Long Term Debt of SaskPower Net of Equity in Sinking Funds ($ millions)

	1989	1990	1991	1992	1993
Without Sale of Shares (No Privatization)	1,885	2,042	2,223	2,331	2,462
With Sale of Shares including Economic Incentive Programs	1,600	1,642	1,769	1,737	1,744
With Sale of Shares excluding Economic Incentive Programs	1,600	1,611	1,707	1,658	1,639

Net Income for SaskPower ($ millions)[25]

	1989	1990	1991	1992	1993
Without Sale of Shares (No Privatization)	101	91	91	83	69
With Sale of Shares including Economic Incentive Programs	259	119	144	160	163
With Sale of Shares excluding Economic Incentive Programs	259	155	174	180	185

The conclusion reached by Peat Marwick is as follows:

> "...we conclude that the proposed sale of shares of SaskEnergy to the public, together with the refinancing of the SaskPower notes and the repayment thereof to SaskPower by SaskEnergy, could allow SaskPower to hold electrical rate increases to three percent per annum, and to flow direct benefits to consumers through an economic incentives program, while attaining higher levels of profitability than would otherwise have been the case."[26]

The Commission endorses the conclusion of Peat Marwick and, accordingly, concludes that the proposed public share offering of SaskEnergy with the resulting reduction of debt and financing cost would have a positive impact on SaskPower and its consumers with rate increases being lower than would otherwise be the case.

The Commission also concludes that SaskPower would receive a fair value for the assets sold.

Additional benefits would accrue to the residents of Saskatchewan from the sale of shares in SaskEnergy because the proposal would improve the debt:equity ratio of SaskPower and therefore reduce the total debt guaranteed by the Province of Saskatchewan. The citizens of Saskatchewan currently have the highest combined per capita public debt of any province in Canada, namely $12 billion, or approximately $12,000 per man, woman and child. The initial reduction of SaskPower debt of $650 million would result in a corresponding reduction in the combined provincial government debt. Investment bankers participating in the hearings told the Commission that without debt reduction, a lowering of the overall provincial credit rating could be anticipated in the short to medium term. In their opinion, this could result in additional finance charges paid by the Government of Saskatchewan of up to $40 million[27] per year. These additional financing costs would either add to the combined deficit or lessen the amount by which the deficit could be reduced in any given fiscal year. As further suggested by several investment dealers, the need for additional borrowings for SaskPower might restrict the government's access to financial markets, thereby reducing the flexibility to introduce new or maintain existing government programs.

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[25] Peat Marwick, Report to the Barber Commission: Analysis of the Proposed SaskEnergy Share Offering on SaskPower Rates.

[26] Peat Marwick, Report to the Barber Commission: Analysis of the Impact of the Proposed Share Offering on SaskPower Rates, Page 6.

7.3 Impact on the Operations of Both SaskPower and SaskEnergy

Concerns were also raised that the separation of SaskPower and SaskEnergy would result in the of loss of economies of scale and increased costs. Such concerns related mostly to duplication of meter reading, billing and mailing costs, and offices in rural areas. SaskEnergy stated that certain functions would continue to be handled jointly, such as meter reading. Increased administrative and salary costs are already reflected in the present operations of SaskEnergy.

The Commission concludes that the costs of duplication are not significant enough to affect rates.

7.4 The Impact on Municipalities

The Commission received briefs and heard from a large number of groups representing rural and urban municipalities regarding the possible impacts of the proposed legislation for SaskEnergy on their revenues.

It should be noted from the outset, that with respect to the issue of the impact of the proposal on municipalities, no draft legislation has been submitted to the Commission, to SaskEnergy or to the affected municipalities for detailed study. Rather, once the Commission had been established, an announcement of the proposal for a franchise fee and municipal taxation of SaskEnergy was made by the Minister of Urban Affairs. The assessments of the Saskatchewan Urban Municipalities and the Commission have all been based on those announcements. This circumstance has not been entirely satisfactory, but unavoidable due to matters beyond the control of all concerned.

The current gas grant system provides for the payment of grants to cities and towns of 5% or 3% (respectively) of revenue from sales of gas by SaskEnergy to consumers within their boundaries. These grants were estimated to total $8.5 million in 1988. This has become an important source of revenue for municipalities, and it continues to increase with inflation and expanded demand.

In 1987, with deregulation of the natural gas industry in Saskatchewan, consumers were permitted to purchase natural gas directly from producers, with SaskPower (later

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[27] Based upon an approximate cumulative 30 basis point increase in interest costs.

SaskEnergy) providing transportation of the gas. These direct sales are not included in the calculation of revenue for gas grants to municipalities as SaskEnergy does not sell the gas to the direct sales customer. Accordingly, the fee is not applied to such sales.

Under the proposal, the current system of gas grants to municipalities would be eliminated and replaced with a franchise fee. This franchise fee, equal to 5% of the revenue from gas sales within the municipality, would apply to all municipalities, including those not currently receiving gas grants. However, under this proposal, all industrial rate payers would be exempted from the franchise fee.

It is estimated that the proposed franchise fee would have generated approximately $10.6 million in revenue in 1988.

The Commission concludes that total revenue paid to all municipalities would increase under the proposed franchise fee. However, with the exemption of industrial rate payers, some municipalities may see a reduction in revenue under the proposed franchise fee.

Under the legislation proposed, SaskEnergy would no longer be a tax exempt Crown corporation. This would result in SaskEnergy's transmission facilities and commercial property becoming subject to municipal property taxes. Taxation on commercial property of SaskEnergy and its subsidiary companies would have amounted to an estimated $500,000 in 1988. Taxes on transmission property would have amounted to $7 million. This amounts to approximately $7.5 million in additional revenues which municipalities are not receiving at present.

Taken collectively the franchise fee, commercial property taxes, and the transmission property taxes would have generated $18.1 million in municipal revenue in 1988. This is approximately $10 million more than is currently received by municipalities. As a group, these three revenue sources would provide almost all municipalities presently receiving gas grants with approximately the same amount of revenue, as well as providing new revenue to municipalities which do not presently receive gas grants. However, this proposal will not, and is not designed to recapture revenue lost by individual municipalities because of deregulation of the natural gas industry and the resulting direct sales.

While the revenues of most municipalities should remain the same, or increase in the case of those not receiving gas grants now, the Commission recognizes that the proposed system would differ materially from the current gas grant system. The potential for growth of revenue for municipalities from increased gas prices would not include industrial rate payers as the present system does. The Commission believes there are two considerations in this respect. First, taxation of the commercial and transmission properties will provide the municipalities with a new and stable revenue source. Second, the potential for increased revenue from industrial rate payers would vary according to the price of natural gas. The difference between potential revenue from taxation of properties of SaskEnergy and revenue increases from industrial rate payers cannot be reasonably estimated.

The Commission concludes that, under present circumstances, if the proposal were to proceed, total municipal revenue would increase.

The Commission also heard varying opinions on how the franchise fee should be implemented if the proposal is carried out. There are a number of details which the Commission feels should be addressed. The question was raised by several municipalities whether the franchise fee should be standardized, or left at the discretion of individual municipalities subject to some maximum. The concern raised by some participants was that this would lead to tax competition between municipalities. It was also felt that it could lead to discriminatory practices by municipalities arbitrarily changing the franchise fee.

The Commission concludes that if the proposal is undertaken, the franchise fee charged should be standard for all municipalities. It would be desirable to entrench the franchise fee in legislation.

A number of municipalities put forward the suggestion that direct sales to industrial companies should also be subject to the proposed franchise fee. This would amount to a tax on the transportation fee charged by SaskEnergy. The Commission understands that since transportation facilities would be subject to municipal property tax under this proposal, taxes paid to municipalities would be reflected in the rates charged by SaskEnergy to direct sales customers for transportation of natural gas. Therefore, any additional levy by a municipality on direct sales would amount to a transportation tax.

The Commission, therefore, considers the imposition of a transportation tax on SaskEnergy customers as being one of the matters for resolution between municipalities and the Provincial Government. There may be other areas requiring resolution between the two levels of government. If the legislation proceeds, consultation on these matters will be required.

When considering the proposed legislation as it relates to municipalities, the Commission believes certain communities deserve special treatment because of their individual circumstances. One such community is Lloydminster, which is served by SaskPower, Northwestern Utilities Limited and Alberta Power. If the proposed legislation is enacted, SaskEnergy must come to some agreement with Lloydminster on servicing. More specifically, Lloydminster needs to be exempted from the exclusive distribution right granted to SaskEnergy under the proposed Saskatchewan Energy Corporation Act because the entire city of Lloydminster now receives its gas service from Northwestern Utilities of Alberta. SaskEnergy has expressed a willingness to resolve this situation if the legislation proceeds.

The Commission concludes the matter of conflicting jurisdictions in Lloydminster should be resolved regardless of the outcome of this proposal.

7.5 The Impact on Surface Rights

The Federation of Saskatchewan Surface Rights Associations is an organization which represents landholders with respect to resource development, utilities and other non-agricultural uses of land. Representatives of the Federation presented to the Commission numerous issues related to surface rights, only some of which are affected by the proposed legislation and within the mandate of the Commission. The Commission feels these issues should be addressed prior to any public share offering in SaskEnergy.

The proposed legislation would grant to SaskEnergy powers associated with natural gas transportation and distribution which are presently possessed by SaskPower. These powers are similar to those granted to B.C. Gas when it acquired the natural gas assets of B.C. Hydro. Included in these powers are broad powers of expropriation that, while perhaps appropriate for a Crown corporation, may not be appropriate for a private-sector corporation. Also, the legislation states that The Saskatchewan Energy Corporation Act should prevail if there is any conflict with any other Act, thereby removing protection granted to landowners by other legislation.

The Commission concludes that greater consideration should be given to the conflict between private ownership rights and the public utility needs. The Commission believes that a further analysis of the implications should be considered and that vesting a private company with all the powers of a Crown corporation may not be appropriate in all circumstances.

CHAPTER VIII - PROPOSED RATE REGULATION OF TRANSGAS AND PROVINCIAL GAS

8.1 History of Natural Gas Utility Regulation in Saskatchewan

Prior to 1983, Saskatchewan utility rates were set and controlled by the Provincial Government. There are a number of reasons for this situation, but mainly it has evolved from government ownership of the utilities. Since government owned the utility, the assumption was that it would act in the best interests of consumers. As a result, no formal-independent regulatory mechanism was seen to be needed.

Without a formalized regulatory mechanism, governments of the day often shouldered the blame for rate increases. There is some evidence that rate setting was a politically motivated process and appears not to have been based on sound economic judgments alone. No political party is "without sin" in terms of this type of rate setting.[28]

In 1983, the Public Utility Review Commission (PURC) was established to provide a formal, arms-length regulatory process for the electrical, natural gas and telephone utilities and compulsory vehicle insurance. PURC operated from 1983 until 1987, when it was disbanded.

8.2 Rate Regulation Principles

A number of principles are generally recognized as being desirable in the regulatory mechanism governing utilities:

i) The principle of fairness in the rates charged to customers is one which all regulators try to maintain. This principle requires that customers, or a particular class of customers, be charged only those costs which are required to service them, not permitting subsidization of one class of consumer by another.

ii) Another principle is protection against inequitable distribution of costs charged to classes of customers between time periods. This problem may occur when current customers of the utility are charged rates which include an undue portion of the costs of the development of the utility in the past or an undue portion of the costs which should be borne by customers in the future.

iii) The guarantee of service is another important regulatory principle. Most utilities provide an essential service and, as a monopoly, it is usually required that the utility develop a plan which will bring about service to all customers wanting such service.

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[28] Schedule of Rate Increases, Appendix A13.

This obligation to develop toward universal service without unduly reducing the financial viability of the utility is an important concept.

8.3 Proposed Regulatory Legislation

The draft legislative bills, along with the Oil and Gas Conservation Act and the Pipe Lines Act, set out the regulatory frame work for SaskEnergy under this proposal. The essential regulatory features of the draft bills are as follows:

Bill 22, The Saskatchewan Energy Corporation Act.

This Act establishes a regulatory framework for the operation of SaskEnergy's transmission subsidiary TransGas. The Act also requires Provincial Gas to continually hold under contract not less than a 15 year supply of gas for its customers.

Bill 23, The Distribution of Gas Rate Regulation Act.

This Act establishes the regulatory system for Provincial Gas which serves approximately 280,000 customers in Saskatchewan, including individual households.

Bill 24, The Public Utility Companies Income Tax Rebates Act.

Under Bill 24, the federal income tax rebate, and the provincial income tax paid by the utility, would be transferred back through the utility for the benefit of the customers. In Alberta, these amounts are separately identified on the customers' bill.

8.4 General

Two different regulatory arrangements have been proposed for SaskEnergy. One would regulate the gathering and transportation functions performed by TransGas, and the other would regulate distribution, which is undertaken by Provincial Gas. The regulatory mechanisms are designed to meet the needs of consumers, while maintaining efficiency in the process. Included in the regulatory proposal is a "transition period" wherein TransGas and Provincial Gas would move from government to independent regulation. The proposed transition period is three years.

Examination of the rate regulation mechanism has been a very complex and detailed endeavour. The Commission requested an independent study by Peat Marwick of the proposed regulatory frame work for both TransGas and Provincial Gas. A copy of this study is attached hereto as Appendix 10 and contains an analysis of the proposed regulation as well as a comparison with that of other jurisdictions.

The Commission evaluated the regulatory proposals for TransGas and Provincial Gas with a view to commenting on weaknesses, strengths, and possible impacts. The Commission did not examine the proposed regulatory process with a view to providing specific detailed recommendations or changes to the proposed legislation.

The Commission has intentionally refrained from reporting the many complex issues surrounding rate regulation. These arguments can be referred to in the briefs presented to the Commission and in the study undertaken at the request of the Commission. Although the Commission has attempted to deal with the proposed rate mechanism in the simplest terms possible, specific language is required to properly describe the process.

8.5 Sale of Natural Gas Assets to SaskEnergy

In June of 1988, SaskEnergy purchased the natural gas division assets from SaskPower. The assets were acquired at $653 million with $625 million for fixed assets and $28 million in current assets. SaskEnergy also assumed current liabilities of $33 million. The net purchase price for the assets was $620 million, which represents a $227 million increase from the SaskPower book value of the asset. The $620 million sale value was arrived at by an independent appraisal which valued the assets on a continued use basis.

Under the proposal, the appraised value of $625 million, rather than the book value of $398 million, would be used for rate making purposes. This would mean that the full $625 million would be placed into the rate base of SaskEnergy. Since the revenue SaskEnergy is allowed to earn is set, in part, by its rate base, this higher appraised value will mean a higher allowed revenue.

At the present time, the rates charged by SaskEnergy are sufficient to provide the allowed revenue notwithstanding the increased rate base of $625 million. Thus if the proposal were to go forward, no increase in rates should result from the higher appraised value being used for rate base.[29]

The Commission concludes that using the appraised value for rate making purposes will not increase rates, and is consistent with a Crown corporation's obligation to obtain full value for assets when they are being sold to the private sector.

8.6 Transition Period

The proposal contains a planned transition period where actual regulation of both TransGas and Provincial Gas would be carried out by the Lieutenant Governor in Council. The transition period would be made up of a base year and the two years immediately following the base year. The precedent for this transition period comes from British Columbia's recent sale of its natural gas assets to an investor owned utility. The Distribution of Gas Rate Regulation Act allows the Lieutenant Governor in Council to make regulations which would set the initial rate base as of December 31, 1988 and any additions to rate base for the base year and each of the two years immediately following the base year. The regulator will not be able to make changes to the initial rate base or additions prescribed by the Lieutenant Governor in Council. The Act also enables the Lieutenant Governor in Council to prescribe the allowed return on the common shareholders' equity for the base year and each of the two years immediately following the base year.

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[29] Definition of Rate Base: the value of the natural gas fixed assets used in providing service. In the case of SaskEnergy, this would be the appraised value of the assets sold to it by SaskPower. (see Legislation for details)

The Commission concludes that, if the proposal were undertaken, the transition period method would provide a reasonable mechanism to move from an unregulated environment to a regulated one. However, the Commission also concludes that the regulator should have the ability to make changes to regulations set by the Lieutenant Governor in Council during the transition period.

8.7 Proposed Regulation of TransGas Limited

TransGas is SaskEnergy's gas transmission subsidiary. At the present time it serves about 200 customers, including Provincial Gas. Almost all these customers are industrial users who purchase gas directly from producers and contract with TransGas to transport it. The form of regulation designed for TransGas customers recognizes their knowledge and sophistication and, accordingly, the regulatory mechanism for these customers is quite different than for individual householders.

Under the proposed legislation, the Oil and Gas Conservation Board (OGCB) would oversee the regulation of rates for TransGas. The Oil and Gas Conservation Board is created and receives its power from The Oil and Gas Conservation Act.

The method of regulation for TransGas is what is known as "regulation by complaint". Under this method, transport customers negotiate rates with TransGas for transmission. If rates can not be agreed upon, they would be arbitrated by the Oil and Gas Conservation Board.

Rates charged by TransGas within Saskatchewan would be what is termed "postage stamp" rates, which means the distance the gas is transported does not affect the rate charged. This method operates much the same way as mailing a letter - the cost being the same regardless of the distance the letter travels.

The Oil and Gas Conservation Board would have the following authority over the transportation rates charged by TransGas.

- On complaint by a customer, the Board would determine just and reasonable rates.

- The Board may vary the rates set by TransGas for no longer than a twelve-month period, but not so as to establish classes of rates which are based on the distance that the gas is transported or the point of receipt of the gas.

- The Board would be empowered to approve rate base additions, only in response to a complaint or on application by TransGas. The Board would have ninety days after a hearing or an application to approve these additions; otherwise the additions would be deemed to have been approved.

- After an initial ten year period for which the Lieutenant Governor in Council would set the depreciation schedule, the Board would determine once every ten years the schedule for calculation of allowed depreciation,

The Commission concludes the regulatory arrangement for TransGas is consistent with prevailing gas transmission regulation in Canada, and would provide a proper and effective method of regulating the service provided by TransGas.

It is the conclusion of the Commission that, with the general changes summarized below, the regulatory structure for TransGas would result in an efficient and effective mechanism. It would also achieve a balance of the interests of the utility, their customers and the government's public policy objectives.

The Commission also suggests that, if the proposal proceeds, the regulatory arrangement for TransGas could be strengthened in several ways:

i) The Oil and Gas Conservation Board should be authorized to review depreciation rates when it considers it necessary.

ii) The Oil and Gas Conservation Board should have the ability to set accounting policies and financial reporting requirements for TransGas.

iii) The conditions of access and service for TransGas should be specified in regulations under the Act.

iv) The procedure should not be such that consumer groups are excluded from representing their interests relating to rates charged by TransGas.

8.8 Proposed Regulation of Provincial Gas Limited

Provincial Gas is the natural gas distribution subsidiary of SaskEnergy. It has a customer base of approximately 280,000 households and businesses, almost all of whom have little or no knowledge of the natural gas industry. Consequently, any regulatory mechanism designed for Provincial Gas should include safeguards to protect these users.

Under the proposed legislation, Provincial Gas would have a regulator separate and distinct from that established for TransGas. Regulation of Provincial Gas would be overseen by a single Gas Commissioner who would be appointed for a ten year term, and who could employ a secretary and retain experts or advisors as considered necessary.

The Gas Commissioner would be empowered to order a review of rates charged by Provincial Gas every third year. In the other two years, Provincial Gas could amend rates using a formula prescribed in The Distribution of Gas Rate Regulation Act. During those two years, the Gas Commissioner would ensure that the allowed revenue of Provincial Gas complied with the formula provided in The Distribution of Gas Rate Regulation Act. The Gas Commissioner would also review the schedule of rates charged to confirm that it would provide the company with the revenue allowed under the formula.

During a review year, the Gas Commissioner could order a hearing to examine any of the following matters:

- the return on rate base for the next 12 months;
- allowed controllable costs (as defined in The Distribution of Gas Rate Regulation Act);
- allowed non-controllable costs, which do not relate to regulated services provided by Provincial Gas;
- the revenue requirement of Provincial Gas for the next 12 months;
- any additions to Provincial Gas's rate base;
- the load forecast for the next 12 months; and
- the schedule of rates already in effect.

Under the proposed legislation, the Gas Commissioner would be precluded from examining certain items. These are:

- the interest expense of Provincial Gas during the review period;
- dividends paid to shareholders;
- debt issue costs;
- the cost of gas to Provincial Gas;
- taxes, levies and franchise fees;
- gas transportation, compression and storage costs; and
- depreciation charges of Provincial Gas during the review period. (These would be set every ten years.)

The Distribution of Gas Rate Regulation Act sets out a formula for calculating the revenue which Provincial Gas is allowed to earn in a given year. The Allowed Revenue[30] is equal to Allowed Controllable Costs[31], plus Allowed Non-Controllable Costs[32], plus Allowed Return on the Rate Base[33] of the company. The formula also provides for the use of a Correction Factor for cost differences between forecast costs for the previous two years and actual costs incurred during that same time period.

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[30] Definition of Allowed Revenue:
= Allowed Return on Rate Base
+ Allowed Controllable Costs
+ Allowed Non-Controllable Costs
- Correction Factor

The correction factor includes a correction for :

- cost of gas
- taxes and levies
- interest expense
- transmission costs
- depreciation charges
- certain controllable costs related to regulated services

The effect of this provision for the correction of a broad range of costs is to provide for an automatic flow-through of cost differences except for those costs which are reviewable by the Gas Commissioner.

The proposed regulatory process for Provincial Gas is experimental and innovative. In any regulatory mechanism, there are trade offs to be made. For example, efficiency competes against thorough evaluation of detail. The Commission believes the mechanism for rate regulation of Provincial Gas may be too innovative for the Saskatchewan environment. Saskatchewan has never had truly independent regulation, even under PURC. Consequently, there is a need to build confidence in the regulatory process. The process outlined in The Distribution of Gas Rate Regulation Act may be too streamlined and not sufficiently accessible to gain public confidence.

After reviewing the regulation proposed for Provincial Gas, the Commission concludes that there are a number of inadequacies in the proposed structure which should be addressed. These are:

- **Proper regulation of Provincial Gas would require at least three Gas Commissioners. These additional two Commissioners may be needed only on a part-time basis during rate reviews.**
- **The regulator should have the authority to hire staff as necessary.**
- **The regulator should have the ability to approve estimated changes in rate base after the transition period. The regulator should have the ability to**

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[31] Definition of Controllable Costs: includes operating, maintenance and administrative expenses. (see Legislation for details)

[32] Definition of Non-Controllable Costs: includes cost of gas; storage compression and treatment costs; regulated transportation charges; franchise fees; income and capital taxes; depreciation; any cost specifically deemed by the Commissioner to be non-controllable. (see Legislation for details)

[33] Definition of Return on Rate Base: is the sum of, the return on the allowed equity of the company, the interest expense of the corporation in a year (including debt issue costs), and the dividends declared on any preferred shares of the corporation in a year. (see Legislation for details)

approve changes in actual rate base when the actual costs are known.

- **The regulator should have the authority to order a hearing into rates any time after new rates are filed by Provincial Gas.**
- **The regulator should have the authority to set accounting policies and financial reporting requirements for Provincial Gas.**
- **The regulator should have the authority to establish a policy for awarding costs to intervenors at a hearing.**
- **The regulator should have the authority to amend depreciation rates as necessary.**
- **The regulator should have the ability to hold hearings when it is deemed necessary by the regulator.**
- **The correction factor should not include a correction for variance in long term interest expense or for variance in depreciation rates. These variances should be the risk of the shareholders.**

8.9 General Conclusions on Rate Regulation

Almost all presenters, whether supporting or opposing the privatization proposal, were of the view that a regulatory mechanism is necessary. The method of regulation may vary depending upon ownership, but not the principles. Regulation of a government owned utility emphasizes that political interference should not distort the real rates. Regulation of a privately owned utility should ensure that there are no excessive profits.

The Commission also heard considerable skepticism, again on both sides of the privatization issue, regarding a truly independent regulatory system. Any regulatory process must be credible in the view of the public. Unless there is confidence that a regulator or regulatory system can offer real protection to the consumer, it will be doomed to failure. The Commission believes that more than the mere technicalities of a regulatory process must be considered. The process must not only be fair but be perceived to be fair.

CHAPTER IX - CONSERVATION AND THE ENVIRONMENT

9.1 Conservation and the Environment

In the course of the hearings and its own studies, the Commission became aware of the following facts and realities:

i) Some 80% of Saskatchewan's electricity is generated by coal-fired generating plants like the Boundary Dam generating station. These thermal-electric plants are not the most environmentally desirable source of power.

ii) As the demand for electricity increases, it is being met by the construction of further "mega projects". The capital costs of such mega projects are very significant and have a major impact on the financial structure of any electrical utility. This in turn has implications for electrical rates.

iii) Capacity can be increased in a gas transmission and distribution system with much smaller increments of capital than it takes for increases in generating capacity in an electrical system.

iv) While the combustion of natural gas still produces carbon dioxide, it is nonetheless a cleaner and more environmentally-acceptable fuel than is coal.

If gas could increasingly be used as a substitute for electricity, savings both in terms of utility rates and in terms of the environment could be realized.

The separation of SaskEnergy from SaskPower should foster competition between the energy sources which may lead to some substitution of gas for electricity.

The Commission believes that the true cost of delivering gas and the true cost of delivering electricity should be known to the consumer. Given proper price signals, the consumer can be presumed to make informed choices and select that energy supply best serving his or her interest. Long-term financial benefits may result in a switch-over from electricity to gas, with long term environmental and financial benefits to Saskatchewan people as a whole.

Cross-subsidization (one class of consumer paying more than his or her share of the cost to the benefit of another class of consumer) makes us unaware of the real cost of the product and therefore less informed in our consumption choices. While cross-subsidization may seem harmless enough, it can have the effect of allowing the demand for electricity to increase uncontrollably with the resulting need to build bigger and bigger projects to feed that demand.

The Commission believes that stringent and effective rate regulation will discourage and gradually disallow cross-subsidization of one class of consumer by another and that the result should be more intelligent use of both gas and electricity.

The Commission also believes that government, at arms-length from SaskEnergy, should vigorously pursue its proper role of setting and monitoring conservation and environmental protection standards.

9.2 Cogeneration

SaskPower is pursuing a policy of examining opportunities for the cogeneration of electricity. At the present time, analysis by SaskPower has not provided any suitably large cogeneration opportunities which would defer planned capital expenditures. However, this area shows some promise for reducing the use of coal and the building of new generation capacity. SaskPower has indicated it will continue to monitor opportunities in this area.

9.3 Time-of-Day Rates

Time-of-day rates involves charging customers different rates for electricity used during peak hours, thereby attempting to encourage consumers to modify their consumption patterns. Theoretically, this will result in lower peak usage and defer the construction of generating facilities. This is currently practised in industrial rate classes, but is thought to be unacceptable to residential and farm customers. The Commission believes that SaskPower should consider extending this practice to other non-residential rate classes to encourage further off-peak usage.

9.4 Purchase of Electricity from Other Utilities

Another alternative to SaskPower expanding generating its own capacity is to enter into long-term purchase contracts from neighbouring utilities with excess capacity, such as Manitoba Hydro. This alternative was suggested by a number of participants and the Commission requested SaskPower to compare the costs of such a long term contract with the costs of electricity from new generating facilities. In response, SaskPower reported that estimated cost of electricity from a newly-constructed generating station was 5.6 cents/kWhr, whereas the effective cost of the Manitoba purchase was 7.8 cents/kWhr. At the present time, such a proposal would lead to higher rate increases than the self-generation option, restrict operating flexibility, and eliminate the economic benefits to the province associated with the construction and operation of a new generation facility.

CHAPTER X - CONCLUSION

Having reviewed the issues, having heard the many representations to it, and having commissioned the previously noted studies, the Barber Commission concludes that the efficacy of the proposed privatization of SaskEnergy comes down to two major issues:

1. The current debt level in SaskPower and the impact of the proposed share offering on such debt level.
2. The potential for diversification of the company itself and, consequently, the province, should the proposal proceed.

Many other issues raised before and studied by the Commission are essentially "neutral" to the issue of ownership. The power and authority of the government of Saskatchewan to legislate, monitor, and regulate is unimpaired by the proposal. The government has full authority to regulate the natural gas industry whether or not SaskEnergy is a shareholder owned corporation. The specific legislated constraints placed on a privatized SaskEnergy by virtue of the proposed Saskatchewan Energy Corporation Act would provide effective control of that corporation so long as the will of the legislature and the government of the day remains resolved to maintain such controls and constraints. The Free Trade Agreement impacts on the operations of a Crown gas company in the same way it would impact on a private shareholder-owned gas company.

The Government of Saskatchewan does not, by virtue of the proposal, lose any authority to set the processes and mechanisms for rate regulation. Rate regulation should be structured by the provincial government regardless whether the gas company is privately or publicly owned.

Consequently, while much was made of the ownership issue, the Commission concludes that the debt issue and the diversification issue noted above are the key "non-neutral" features requiring study and assessment by the people of the province.

Much of what the Commission heard might be considered politically based opinion in the sense that the presenters had strong philosophical views largely centering around the more ideological issues of ownership and control. These views ranged from extreme versions of the free market to extreme versions of state intervention. The expression of radical views is healthy in the political process in that such views define the parameters of the debate. However, such extremism lends little assistance to the process of endeavouring to reach a reasonable and practical compromise and a balanced view of the problem.

While few presentations expressed the truly extreme ends of the political and economic spectrum, most presenters were polarized around the conflicting pros and cons of "public ownership" versus "private ownership". Proponents of public ownership through Crown corporations fundamentally believe that government, through a Crown corporation, could more effectively operate the gas utility; that the industry was of such significance that government ought to operate the utility industry; and that government rate setting was ultimately in the public interest. Proponents of private ownership believe that private enterprise is more efficient; able to react better and faster; and that government should not be in a position of trying to regulate itself. Both proponents and opponents of the proposal generally had deeply held convictions in respect of the ownership and control issue and in respect of the ultimate effectiveness of a Crown corporation versus a shareholder owned corporation.

Such deeply held philosophical beliefs and convictions are virtually irreconcilable. Consequently, the Commission has not attempted to reconcile them. The debate inevitably must be carried forth and dealt with in the political arena.

In respect of the issues noted above, the Commission concludes that the proposal for a public share offering in SaskEnergy does have the capability of attaining the objective of reducing the debt level in SaskPower. The practical effect of the proposal would be to shift a portion of the SaskPower debt to the private company, SaskEnergy.

The assets previously owned by the gas division of SaskPower have been transferred to SaskEnergy at their appraised value. The appraised value exceeds the book value and hence the transfer value is favourable to SaskPower. The Crown corporation is realizing a significant capital appreciation on the gas assets and, in the view of the Commission, this results in a positive benefit to the people of the Province.

The Commission further believes that the privatization of SaskEnergy as proposed has the potential to achieve the diversification objective. Given the rapid globalization of the world economy, there are significant opportunities for a gas utility in related gas-based industries. However, given the pace of access to information, modern decision making, and the sophistication of capital markets, any enterprise wishing to participate in such opportunities must be able to respond promptly and without regard to political constraints. In order to fully take advantage of intra-provincial and extra-provincial opportunities, such a diversified company has greater likelihood of success if it is not in competition with education, health and welfare for government time and attention and government funding.

The Commission concludes that the rate regulatory process must be studied in much greater detail if this proposal is to proceed. However, if the proposal does not proceed, consideration should be given to regulation of rates set by the Crown owned gas and electrical utilities.

The Commission is grateful to all participants for their courteous appearances before the Commission. It was heartening to the Commission members and staff that the many strongly held views were sincerely presented in an open and honest atmosphere. There was no sense of intimidation present at any hearing, notwithstanding the differences of opinion amongst members of the audience at any given time. It is particularly gratifying that the democratic right of freedom of speech is alive and well in the Province of Saskatchewan.

The Commission also observed that the healthy level of freedom of speech is accompanied by an unhealthy level of cynicism, scepticism, pessimism and distrust of both government and business. Because our attitude to change and challenge impacts so significantly upon our management of change and our response to challenge, the Commission sees a tremendous need for a more positive outlook and more creative solutions to problems as we move toward the 21st Century.

The Commission has endeavoured to inform the political debate - not to decide or resolve it. The Commission would urge the people of Saskatchewan, in their own consideration of the proposal to privatize SaskEnergy, to be analytical and unemotional - to look to the future and not to the past, and to continue to express such views as they believe to be consistent with the welfare of this province.

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APPENDIX A1

MINISTERIAL ORDER

I, Grant Devine, President of the Executive Council, do hereby order pursuant to section 74.2 of the Legislative Assembly and Executive Council Act, the creation of an advisory committee, to exist until October 1, 1989 and to be known as the Commission on SaskEnergy Public Participation, consisting of the following persons:

Lloyd Barber, Chairman
Ken Sarsons, Member
Kathryn Ford, Member

The Commission shall operate on the following terms and conditions:

(a) inquire into and report in accordance with the Terms of Reference attached hereto;

(b) complete and submit its final report to the President of the Executive Council by October 1, 1989; and

(c) hold public hearings and consultations as the Commission sees fit throughout Saskatchewan.

The Chairman of the Commission shall be reimbursed at the rate of $450.00 for each day that he is necessarily engaged in the work of the Commission.

The Members of the Commission shall be reimbursed at the rate of $350.00 for each day that he or she is necessarily engaged in the work of the Commission. Expenses for the Chairman and members to be reimbursed at rates authorized for members of the public service.

Dated at Regina, Saskatchewan, this 9th day of May, 1989.

APPROVED BY: President of Council

MINISTERIAL ORDER

I, Grant Devine, President of the Exeuctive Council, do hereby extend the duration for the Commission on SaskEnergy Public Participation from October 1, 1989, to November 3, 1989.

The Commission on SaskEnergy Public Participation was authorized as an advisory committee by Ministerial Order dated May 9, 1989, pursuant to Section 74.2 of The Legislative Assembly and Executive Council Act. The terms and conditions remain as stated in the May 9, 1989, order, with the exception of the expiry date.

Dated at Regina, Saskatchewan, this 28th day of September, 1989.

APPROVED BY: President of Council

APPENDIX A2

MANDATE STATEMENT

Natural gas is a vital ingredient in the lives of Saskatchewan residents. It is used to heat our homes. It is used as a raw material for such things as ammonia fertilizer and plastics. It is a feedstock that is required for the upgrading of heavy oil, allowing Saskatchewan crude oil to be refined in Saskatchewan to meet our energy needs.

Saskatchewan was blessed with natural resources - including crude oil and natural gas. The immergence of a natural gas industry in Saskatchewan creates many opportunities for the province and its residents. However, it also requires that the role of the Government of Saskatchewan as the industry's major participant through a role as the industry's regulator be re-examined.

The natural gas industry has undergone significant changes in the past two decades. The industry was heavily impacted by the oil embargoes of the 1980s. There were questions about the export of natural gas which were studied by the National Energy Board in Ottawa. Deregulation within the industry has substantially changed the roles of the industry's participants - consumers, distributors, transporters, producers and regulators.

The Government of Saskatchewan has proposed that the public be allowed an opportunity to participate in the natural gas industry in Saskatchewan. This proposed opportunity is in the form of a public share offering in SaskEnergy, the transporter and distributor of natural gas in Saskatchewan.

The Barber Commission on SaskEnergy Public Participation was established to investigate the impact of public participation in SaskEnergy. The Commission will:

- hold informal public hearings at various locations in Saskatchewan to receive submissions from interested parties; and

- inquire into and report on the subject matter raised by:

  The Saskatchewan Energy Corporation Act
  The Distribution of Gas Rate Regulation Act
  The Public Utility Companies Income Tax Rebates Act
  The Power Corporation Amendment Act, 1989

including, but not limited to:

1. The impact on consumers of natural gas following a public share offering in SaskEnergy;
2. The appropriateness and effectiveness of the proposed rate regulation mechanisms for the distribution of natural gas;
3. The impact of a public share offering in SaskEnergy on rates charged by the parent company, SaskPower for electricity;
4. The impact on the general operation of SaskPower from a public share offering in SaskEnergy;
5. The potential for diversification of the provincial economy through a public share offering in SaskEnergy;
6. The potential for jobs for Saskatchewan residents arising from public participation in SaskEnergy;
7. The potential for diversification of SaskEnergy following a public share offering;
8. The potential for expansion of SaskEnergy both intra-provincially and extra-provincially both with and without a public share offering in SaskEnergy;
9. The security of supply of natural gas for the residents of Saskatchewan both with and without a public share offering in SaskEnergy; and
10. The impact of public share offering in SaskEnergy on municipalities thoughout Saskatchewan.

APPENDIX A3

TERMS OF REFERENCE

COMMISSION ON SASKENERGY PUBLIC PARTICIPATION

The Commission on SaskEnergy Public Participation has responsibility to inquire into and report on the subject matter raised by The Saskathewan Energy Corporation Act, The Distribution of Gas Rate Regulation Act, The Public Utility Companies Income Tax Rebates Act and The Power Corporation Amendment Act, 1989, including, but not limited to the following:

1. The impact on consumers of natural gas following a public share offering in SaskEnergy;
2. The appropriateness and effectiveness of the proposed rate regulation mechanisms for the distribution of natural gas;
3. The impact of a public share offering in SaskEnergy on rates charged by the parent company, SaskPower, for electricity;
4. The impact on the general operation of SaskPower from a public share offering in SaskEnergy;
5. The potential for diversification of the provincial economy through a public share offering in SaskEnergy;
6. The potential for jobs for Saskatchewan residents arising from public participation in SaskEnergy;
7. The potential for diversification of SaskEnergy following a public share offering;
8. The potential for expansion of SaskEnergy both intra-provincially and extra-provincially both with and without a public share offering in SaskEnergy;
9. The security of supply of natural gas for the residents of Saskatchewan both with and without a public share offering in SaskEnergy; and
10. The impact of a public share offering in SaskEnergy on municipalities throughout Saskatchewan.

APPENDIX A4

RULES OF PROCEDURE

1. The Commission shall determine suitable locations for holding informal hearings and shall determine the dates, times and places for such hearings.

2. Those person(s) desiring to appear before the Commission should advise the Commission in writing of their intention to appear and submit a written brief to Commission address, being:

   Suite 101
   1819 Cornwall Street
   Regina, Saskatchewan
   S4P 2K4

   on or before the 14th day of July, 1989.

3. The hearings shall be of an informal nature to encourage all interested parties to partake at the hearings; the representations shall be subject to questions posed by Commission members only.

4. All aspects of the hearings shall be completely open to the participants and to the public. All of the materials and documents received by the Commission during the course of the inquiry shall be open for examination by the Public.

5. The brief, preferably, will be typewritten and four copies delivered to the Commission. If, however, the presenter is not able to have the brief typewritten, it shall be legible handwriting. The brief shall include:

   a) The name, address and signature of the person presenting the brief, the name and address of the person(s) preparing the brief, and the group or organization, if any, that the person presenting the brief, or the person preparing the brief, is a member of.

   b) The names of any studies, reports or documents, together with the authors, which are referred to directly or indirectly in the brief.

   c) The names of any studies, reports or documents, together with the authors, which are referred to directly or indirectly in the brief.

6. The Commission retains the power to add to, alter, modify or suspend any rule or part thereof.

APPENDIX A5

LIST OF PEOPLE/ORGANIZATIONS INVITED TO PARTICIPATE

Mr. James Clarke **A.P. Green Refractories**
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Mr. R. J. Liptrap Box 2200, Streetsville Mississauga Ontario L5M 2H3	General Manager	**Du Pont Canada Inc.**
Ms. Carol Osinski P.O. Box 517 Eastend Saskatchewan S0N 0T0	Treasurer	**Eastend Rink Complex, Inc.**
Mr. Lloyd Rogers **Force/Cdn. Comm. Buildings** 1779 Albert Street Regina Saskatchewan S4P 2S7		**Energy Management Task**
Mr. Gordon MacMurchy 760 Arcola Avenue Regina Saskatchewan S4N 0S5	President	**Family Farm Foundation of Canada**
Mr. Terry Crush **Assoc.** Box 53 Lone Rock Saskatchewan S0M 1K0		**Federation of Sask Surface Rights**
Mr. Hugh J. Wagner 2334 McIntyre Street Regina Saskatchewan	Secretary-Manager	**Grain Services Union (C.L.C.)**
Mr. Lorne A. Swalm Box 995 Kindersley Saskatchewan S0L 1S0		**individual**
Mr. Terry Alm 42 Riel Crescent Saskatoon Saskatchewan		**individual**
Mr. Chuck Alton Box 142 Neville Saskatchewan S0N 1T0		**individual**
Mr. Brooklyn Anderson Indian Head Saskatchewan		**individual**
Ms. Roberta Anderson 8 - 3320 Garnet Street Regina Saskatchewan S4S 1X9		**individual**
Ms. Irene Angele Seiferling 1705 Shannon Crescent Saskatoon Saskatchewan S7H 2T8		**individual**
Mr. Roy Atkinson Box 340 Landis Saskatchewan S0K 2K0		**individual**
Mr. Dale Baldwin 72 Richardson Crescent Regina Saskatchewan S4S 4J3		**individual**
Ms. Joan Baron 1801 Hamilton Street Regina Saskatchewan S4P 4J2		**individual**

Mrs. Catherine Barrie 1571 Garnet Street Regina Saskatchewan S4T 2Y8	individual
Mr. Kasper Beitel 810 - 3rd Street Estevan Saskatchewan S4A 0R1	individual
Ms. Tannis Bennett Grenfell Saskatchewan	individual
Mr. Blair Bergen 1130 - 3rd Street Estevan Saskatchewan S4A 0R7	individual
Mr. Lawrence Bergreen 1400 Jubilee Drive Swift Current Saskatchewan S9H 2A3	individual
Mr. R. Blair P.O. Box 2535, Postal Station "M" Calgary Alberta T2P 2N6	individual
Mr. Gordon Bosley 34 Hahn Crescent Kindersley Saskatchewan	individual
George R. Bothwell 202 - 1819 Cornwall Street Regina Saskatchewan S4P 2K4	individual
Mr. Milt Carlson #24 - 2420-6th Avenue N. Regina Saskatchewan S4N 0N9	individual
Mr. Rusty Chartier 1245 Avenue O South Saskatoon Saskatchewan S7M 1K2	individual
Mr. Mar Clary Box 41 Leader Saskatchewan S0N 1H0	individual
Mr. Eric Cline 30 Kirk Crescent Saskatoon Saskatchewan S7H 3B2	individual
Mr. Fred Clipsham 2305 Cameron Street Regina Saskatchewan S4T 2W2	individual
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Mr. George Danychuk Box 159 Maidstone Saskatchewan S0M 1M0	individual
Mr. Bob Dickson Wolseley Saskatchewan	individual
Mr. Murray Dobbin Suite 308, 2315 McIntyre Street Regina Saskatchewan S4P 3Y8	individual

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Mrs. Mabel E. Colquhoun Box 39 Cupar Saskatchewan S0G 0Y0	individual
Mr. Thomas E. Keyes 12 - 2153 Lorne Street Regina Saskatchewan S4P 3K3	individual
Mr. Jack Elfenbaum 213 - 67 Woodlily Drive Moose Jaw Saskatchewan S6J 1G6	individual
Ms. Alice Ellert Box 868 Assiniboia Saskatchewan S0H 0B0	individual
Mr. Ken Evans General Delivery Lumsden Saskatchewan S0G 3C0	individual
Mr. J. F. Conway 127 Angus Crescent Regina Saskatchewan S4T 6N1	individual
Mr. Donald F. Woloshyn 54 Marlborough Crescent Saskatoon Saskatchewan S7L 3T7	individual
Mr. Henry F. Feldkamp 427 Lakeshore Bay Saskatoon Saskatchewan S7J 3T5	individual
Mr. Robert Fink 516 Avenue K South Saskatoon Saskatchewan S7M 2E2	individual
Mr. Herbert G. Magnusson Box 384 Rosetown Saskatchewan S0L 2V0	individual
Ms. Maryann Gerard 620 Mullin Avenue Regina Saskatchewan S4N 1C9	individual
Ms. Maxine Gerwing 2706 Cumberland Avenue S. Saskatoon Saskatchewan	individual
Mr. John Gormley 231 - 4th Avenue South Saskatoon Saskatchewan S7K 1N1	individual
Mr. Keith Hanson 51 Dragan Crescent Saskatoon Saskatchewan S7H 5C8	individual
Mr. Warren Hanson 904D-22nd Street W. Saskatoon Saskatchewan S7M 0S1	individual

Mr. Glen Harrison Box 502 Kindersley Saskatchewan S0L 1S0	individual
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Mr. Bob Hill Box 65 Lumsden Saskatchewan S0G 3C0	individual
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Mr. Larry Hubich 23 Spiess Bay Regina Saskatchewan S4R 7N9	individual
Mr. Bill Hume 322 Spruce Drive Estevan Saskatchewan S4A 0A2	individual
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Mr. Randy Johnson c/o 8 - 3320 Garnet Street Regina Saskatchewan S4S 1X9	individual
Mr. Michael Jones c/o 8 - 2230 Garnet Street Regina Saskatchewan S4S 1X9	individual
Mr. Roger Kaeding Box 150 Churchbridge Saskatchewan S0A 0M0	individual

Mr. Ron Kidd Box 13 Lumsden Saskatchewan S0G 3C0	individual
Mr. Wayne Kinnee 4214 - 8th Avenue Regina Saskatchewan S4T 0T7	individual
Mr. Bill Klempp Box 106 Lumsden Saskatchewan S0G 3C0	individual
Mr. John Knox Box 84 Kindersley Saskatchewan S0L 1S0	individual
Mr. Geo L. Tweedie Box 89 Macrorie Saskatchewan S0L 2E0	individual
Mr. Terry Laughren 310 - 351 Saguenay Drive Saskatoon Saskatchewan	individual
Ms. Dianne M. Antifaiff #14 - 55 Angus Road Regina Saskatchewan S4R 3L1	individual
Mr. Bill Macza 1418 East Heights Saskatoon Saskatchewan S7J 3B3	individual
Ms. Jean Maksymiuk 1025 - [illegible]th Street East Prince Albert Saskatchewan S6V 0L1	individual
Mr. George Marcotte 232 - 12th Avenue Estevan Saskatchewan S4A 2E1	individual
Mr. Brian Marcotte 232 - 12th Avenue Estevan Saskatchewan S4A 2E1	individual
Mr. Ted Mather 814 - 4th Street Estevan Saskatchewan S4A 0V9	individual
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Mr. Don McGregor #7-2231 Albert Street Regina Saskatchewan	individual
Mr. Gary McKechney Box 160 Bienfait Saskatchewan S0L 0M0	individual
Mr Jim Metherell Box 343 Lasburn Saskatchewan S0M 1H0	individual

Mr. Reuban Mills Box 129 Fleming Saskatchewan S0G 1R0	**individual**
Mr. Jimmy Montgrand Christopher Lake Post Master Christopher Lake Saskatchewan S6V 2V6	**individual**
Mr. Jeff Morrison P.O. Box 7545 Saskatoon Saskatchewan S7K 4L4	**individual**
Mr. Randy Nelson 1105 Osler Street Saskatoon Saskatchewan S7L 0T6	**individual**
Mr. Bob Nicholson 314 Saskatchewan Crescent W. Saskatoon Saskatchewan	**individual**
Mr. Wes Norheim 2267 Albert Street Regina Saskatchewan S4P 2V5	**individual**
Mr. Gay Patrick Box 832 Esterhazy Saskatchewan S0A 0X0	**individual**
Mr. Robert Patton 8 - 50 Read Avenue Regina Saskatchewan S4T 7R6	**individual**
Ms. Bonnie Pearson Box 1521 Moose Jaw Saskatchewan S6H 7A8	**individual**
Mr. Ivan Peterson Hazel Dell Saskatchewan	**individual**
Mr. Herb Pinder Suite 760, 410 - 22nd Street E. Saskatoon Saskatchewan S7K 5T6	**individual**
Mr. Ken Plante 111 Merlin Crescent Regina Saskatchewan S4R 3E6	**individual**
Ms. Wilma Poage 721- 4th Street Estevan Saskatchewan S4A 0V6	**individual**
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Mr. Armand Quessy Debden Saskatchewan S0J 0S0	**individual**
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Mr. Stan Rice individual
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Mr. Wes Robbins individual
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Mr. Ed. Sikorski individual
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Mr. Harold Sinkinson individual
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Mr. Ernie Spencer individual
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Mr. Frank Spenrath individual
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Mr. A. Taylor individual
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Ms. Lois Thacyk individual
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Mr. John Vinge individual
Wolseley Saskatchewan

Mr. Alfred Wagner individual
Box 68 Silton Saskatchewan S0G 4L0
Mr. Tom Waller individual

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Mr. Roger Phillips 617 Park Street Regina Saskatchewan S4N 5N1		**Institute for Saskatchewan Enterprise**
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Mr. Doug Gillard 1660 - 1920 Broad Street Regina Saskatchewan S4P 3V2		IPAC
Mr. G. C. Backman P.O. Box 1670 Regina Saskatchewan S4P 3C7	Senior Vice President	IPSCO Inc.
Mr. D. H. Geesen 1200 - 1801 Hamilton Street Regina Saskatchewan S4P 4B5		Kalium Canada Ltd.
Mr. Evan Swalm Box 1572 Kindersley Saskatchewan S0L 1S0		Kindersley New Democratic Party
Mr. Harold Huber 300 - 2114 - 11th Avenue Regina Saskatchewan S4P 0J5		McKercher McKercher Laing & Whitmore
Mr. Daryl W. Howard Suite 400, 530-8th Avenue S.W. Calgary Alberta T2P 3S8	Senior V.P. & Director	Merrill Lynch Canada Inc.
Ms. Marion E. Tolley 637 Main St. N. Moose Jaw Saskatchewan S6H 0W5	Secretary	Moose Jaw Senior Citizens "Action Now"
Ms. Nancy Redekop 1333 - 7th Avenue N.W. Moose Jaw Saskatchewan S6H 4L8		Moose Jaw Labour Council
Mr. Larry Brown 2841 Riverside Drive, Suite 204 Ottawa Ontario K1V 8N4	National Sec.-Treasurer	National Union of Provincial Gov't Employees
Mr. John D. Jamieson 380 Gardiner Park Court Regina Saskatchewan S4V 1R9		National Trust
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Mr. Al McDougall 1171, 2103 - 11th Avenue Regina Saskatchewan S4P 3Z8		Nesbitt Thomson
Mr. Chris K. Sheard 10035-105 Street Edmonton Alberta T5J 2V6	V.P., General Counsel	Northwestern Utilities Limited
Mr. David Lyons 2400 - 400 - 3rd Avenue S.W. Calgary Alberta T2P 4H2		Ocelot Industries Ltd.
Mr. Jack S. Thompson Ltd. 205 First Avenue N.W. Moose Jaw Saskatchewan S6H 7Z2		Ormiston Mining & Smelting Co.

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Mr. Corey Olynik Suite 200 - 2150 Scarth Street Regina Saskatchewan S4P 2H7		**P.C. Party**
Mr. Randy Poole 2135 Albert Street Regina Saskatchewan S4S 2V1		**PIMA**
Mr. Carl Kwialkowski Box 152 Porcupine Plain Saskatchewan S0E 1E0		**Porcupine Opportunities Program**
Mr. Trent Webster **Federation** 1374 Cowan Drive Prince Albert Saskatchewan S6V 2R2	**President**	**Progressive Conservative Youth**
Mr. Glenn Larson Box 182 Pilot Butte Saskatchewan S0G 3Z0		**Qu'Appelle/Lumsden NDP**
Mr. Dave Reiger Grayson Saskatchewan	**Reeve**	**R. M. of Grayson**
Mr. Jim Reiter Box 366 Rosetown Saskatchewan S0L 2V0		**R.M. of Marriott**
Mr. Tony Fell **Inc.** 6th Floor, 2103 - 11th Avenue Regina Saskatchewan S4P 3Z8		**RBC Dominion Securities Pemberton**
Mr. Brian Kinder 2145 Albert Street Regina Saskatchewan S4P 2V1		**Regina Chamber of Commerce**
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Mr. Doug Emsley 1650 - 1920 Broad Street Regina Saskatchewan S4P 3V2		**SabreWest Oil & Gas Ltd.**
Mr. Steve Bobiash Box 399 Allen Saskatchewan S0K 0C0		**Sask Young New Democrats**
Mr. Ted Boyle Room 103, 2709 - 12th Avenue Regina Saskatchewan S4T 1J3		**Saskatchewan Federation of Labour**
Mr. Jim Chase 1935 Elphinstone Street Regina Saskatchewan S4T 3N3		**Saskatchewan Construction Association**

Mr. Ted Cholod President **Saskatchewan Urban Municipalities Association**
200 - 1819 Cornwall Street Regina Saskatchewan S4P 2K4

Mr. Brian Davidson **Saskatchewan Dehy Association**
Tisdale Saskatchewan S0E 1T0

Mr. John Empey **Saskatchewan Assoc. of Broadcasters**
c/o City of Estevan Estevan Saskatchewan

Mr. Bob Finlay **Saskatchewan Chamber of Commerce**
1630 - 1920 Broad Street Regina Saskatchewan S4P 3V2

Mr. T. H. Renner President & C.E.O. **Saskatchewan Oil and Gas Corporation**
P.O. Box 1550 Regina Saskatchewan S4P 3C4

Mr. Daniel Kwochka President **Saskatchewan Alliance for Social & Economic Progress**
2500 McKay Street Regina Saskatchewan S4N 2T5

Mr. Larry Lang **Saskatchewan Recreation Facility Association**
Box 760 Broadview Saskatchewan S0G 0K0

Ms. Beth Smillie Communications Officer **Saskatchewan Government Employees Union**
1440 Broadway Avenue Regina Saskatchewan S4P 1E2

Mr. Jack Thompson Chairman **Saskatchewan Industrial Gas Users Association**
205 - 1st Avenue N.W. Moose Jaw Saskatchewan S6H 7Z2

Mr. Maurice Neault **Saskatoon Blue Line Twin Ice Arena**
Box 246 R.R. #4 Saskatoon Saskatchewan S4K 3J7

Mr. Dan Wicks **Saskatoon Minor Hockey Association**
Bay 8-816-1st Avenue N. Saskatoon Saskatchewan S7K 1Y3

Mr. O. W. Hanson President & C.E.O. **SaskEnergy Corporation**
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Mr. George D. Hill President & C.E.O. **SaskPower**
2025 Victoria Avenue Regina Saskatchewan S4P 0S1

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Ms. Charlotte Hookenson		**Souris-Cannington New Democratic Party**	Box 117 Kisbey Saskatchewan S0C 1L0
Mr. Dave Tkachuk	President	**Strategic Public Affairs**	102 - 1112 Winnipeg Street Regina Saskatchewan S4R 1J6
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Mr. Peter C. Perdue	V.P. Corporate Finance	**Toronto Dominion Securities Inc.**	P.O. Box 100 Toronto Dominion Centre Toronto Ontario M5K 1G8
Mayor Allan Mayer	Mayor	**Town of Archerwill**	Archerwill Saskatchewan
Mayor John Popp	Mayor	**Town of Bjorkdale**	Box 122 Bjorkdale Saskatchewan S0E 0E0
Mayor Lloyd Stimpson	Administrator	**Town of Hudson Bay**	Box 730 Hudson Bay Saskatchewan S3E 0Y0
Mr. Don Warner	Town Administrator	**Town of Balcarres**	Balcarres Saskatchewan S9G 0C0
Mr. Ken Magnus		**Trail-Rite Flatdecks Ltd.**	Box 1718 Tisdale Saskatchewan S0E 1T0
Mr. Mike Heier		**Trinity Energy Ltd.**	P.O. Box 1859 Lloydminster Saskatchewan S9V 1N4
Ms. Deborah Fishley	President	**U of R PCYF**	35 Meadow Way Regina Saskatchewan S4N 4G0
Mr. Merv Harrison		**United Church of Canada**	c/o Univ. of Sask. Physical Plant Saskatoon Saskatchewan S7N 0W0
Mr. Leonard B. McCurdy	Chief Executive Officer	**WESTBRIDGE Computer Corporation**	1801 Hamilton Street Regina Saskatchewan S4P 4J2

Mr. Steve Foley P.O. Box 144 Weyburn Saskatchewan S4H 2J9	**Weyburn Labour Council**
Mr. E. King P.O. Box 274 Royal Trust Tower Toronto Dominion Centre Toronto Ontario M5K 1M7	**Wood Gundy Inc.**
Mr. John Ritchie 1E - 2121 Saskatchewan Drive Regina Saskatchewan S4P 4A7	**Wood Gundy Limited**
Mr. T. Woods P.O. Box 274 Royal Trust Tower Toronto Dominion Centre Toronto Ontario M5K 1M7	**Wood Gundy Inc.**
Mr. Gerry McGregor Box 400 Yorkton Saskatchewan S3N 2W3	**Yorkton Agri-Plex**
Mr. Ken Christoffel President c/o 2237 Broad Street Regina Saskatchewan	**Young Entrepreneurs**

APPENDIX A7

The Barber Commission on
SaskEnergy Public Participation

June 21, 1989

Name
Organization
Address

Dear Name:

RE: BARBER COMMISSION ON SASKENERGY PUBLIC PARTICIPATION

Thank-you for the interest you have expressed regarding Public Participation in SaskEnergy. Please find enclosed copies of the Terms of Reference for the Commission and the Rules of Procedure for the public hearings.

Members of the Commission are: Chairman, Dr. Lloyd Barber, University of Regina President, Ken Sarsons, former Chief Executive Officer of CSP Foods of Saskatoon and Kathryn Ford, Saskatoon family lawyer.

The members of the Commission feel that public input is the key element of their mandate. They are hopeful that a broad cross-section of individuals, organizations and companies will come forward to present their views.

We would like to invite you to participate in the process. If you intend to submit a brief please notify our office of this intent. If after reviewing this package of information, you require additional information or have questions please contact Bob McDonald, Director of Research, at our office.

Sincerely,

Gary J. Drummond
Secretary

Enclosures

Suite 101, 1819 Cornwall Street
Regina, Saskatchewan S4P 2K4
Phone 787-9809
FAX 787-9808

Commission on
SaskEnergy Public Participation

Rules of Procedure

1. The Commission shall determine suitable locations for holding informal hearings and shall determine the dates, times and places for such hearings.

2. Those person(s) desiring to appear before the Commission should advise the Commission in writing of their intention to appear and submit a written brief to Commission address, being:

   Suite 101
   1819 Cornwall Street
   Regina, Saskatchewan
   S4P 2K4

   on or before the 14th day of July, 1989.

3. The hearings shall be of an informal nature to encourage all interested parties to partake at the hearings; the representations shall be subject to questions posed by Commission members only.

4. All aspects of the hearings shall be completely open to the participants and to the public. All of the materials and documents received by the Commission during the course of the inquiry shall be open for examination by the Public.

5. The brief, preferably, will be typewritten and four copies delivered to the Commission. If, however, the presenter is not able to have the brief typewritten, it shall be legible handwriting. The brief shall include:

a) The name, address and signature of the person presenting the brief, the name and address of the person(s) preparing the brief, and the group or organization, if any, that the person presenting the brief, or the person preparing the brief, is a member of.

b) The names of any studies, reports or documents, together with the authors, which are referred to directly or indirectly in the brief.

6. The Commission retains the power to add to, alter, modify or suspend any rule or part thereof.

Commission on
SaskEnergy Public Participation

Terms of Reference

The Commission on SaskEnergy Public Participation has responsibility to inquire into and report on the subject matter raised by The Saskatchewan Energy Corporation Act, The Distribution of Gas Rate Regulation Act, The Public Utility Companies Income Tax Rebates Act, and The Power Corporation Amendment Act, 1989, including but not limited to the following:

1. The impact on consumers of natural gas following a public share offering in SaskEnergy;
2. The appropriateness and effectiveness of the proposed rate regulation mechanisms for the distribution of natural gas;
3. The impact of a public share offering in SaskEnergy on rates charged by the parent company, SaskPower, for electricity;
4. The impact on the general operation of SaskPower from a public share offering in SaskEnergy;
5. The potential for diversification of the provincial economy through a public share offering in SaskEnergy;
6. The potential for jobs for Saskatchewan residents arising from public participation in SaskEnergy;
7. The potential for diversification of SaskEnergy following a public share offering;
8. The potential for expansion of SaskEnergy both intra-provincially and extra-provincially both with and without a public share offering in SaskEnergy;
9. The security of supply of natural gas for the residents of Saskatchewan both with and without a public share offering in SaskEnergy;
10. The impact of a public share offering in SaskEnergy on municipalities throughout Saskatchewan.

APPENDIX A8

SCHEDULE OF HEARING DATES, LOCATIONS AND PARTICIPANTS PRESENTING

Date (1989)	Location	Presenter
Wednesday, July 26	Regina	SaskPower
Thursday, July 27	Regina	SaskEnergy
Thursday, August 3	Estevan	John Empey
		Steve Foley, Weyburn Labour Council
		Evelyn Johnson
		Kasper Beitel
		Donna Cowie, Souris-Cannington PC
		Bill Hume
		Reuban Mills
		Brian Marcotte
		George Marcotte
		Gerry Wright
		Blair Bergen
		Gary McKechney
		Charlotte Hookenson, Souris-Cannington NDP
Friday, August 4	Yorkton	Roger Kaeding
		Jim Prokopiuk
		Larry Lang, Saskatchewan Recreation Facilities Association
		Ken Magnus
		Ivan Peterson
Wednesday, August 9	Lloydminster	Chris Sheard, Northwestern Utilities Ltd.
		Chris Sheard, Alberta Power Ltd.
		Mike Heier, Trinity Energy
		Hugh Lappin
		Roger Brekko, City of Lloydminster
		Ray Nelson, Nelson Lumber
		Sylvia Payne, North Battleford & District Labour Council
Thursday, August 10	Kindersley	Lorne Swalm
		Hugh Danielson
		Jim Reiter, Four Rural Municipalities

		John Knox, behalf of Evan Swalm John Knox Herbert Magnusson Pat Jerome
Friday, August 11	Swift Current	Len Stein, City of Swift Current Orlo Drewitz Alice Ellert Chuck Alton Marvin Shatosky Mar Clary Harold Sinkinson George Tweedie
Thursday, August 17	Prince Albert	Mayor Gordon Kirkby, City of Prince Albert Mayor Carol Carson, City of Melfort Forrest Lawrie, Randy Pugh, C.C. Gale; Briarlea Holbien Wheat Pool Jimmy Montgrand J. W. Marshall, Grant Fulton, Randy Robert; Shellbrook-Torch River NDP Stan Rice Pat Weir Lyle Zuk
Tuesday, August 22	Regina	Mayor Doug Archer, City of Regina Mr. David Mitchell, Alberta Energy James Pitbaldo, Bruce Hodge, Dennis Mulvihill; RBC Dominion Securities Pemberton Robert Blair, Robert Pierce Ted Renner, Jim Jeffrey; SaskOil David Lyons, Ocelot Industries John Conway Daryl Howard, Merrill Lynch Canada Richard Hillary, Doug Gillard; IPAC Glenn Larson Jim Chase Fred Clipsham Jack Thompson, Don Geesen, Jim Brown; SIGUA, Ormiston Mining & Inland Cement

Wednesday, August 23	Regina	Doug Cunningham, Burns Fry Ltd. Don Carmichael, Thomas Kearns; Scotia McLeod Inc. Dave Maki, Don Anderson; Sask Federation of Labour Marion E. Tolley, Moose Jaw Senior Citizens 'Action Now' Group Ken Christoffel,Young Entrepreneurs Joel Scott Ernie Spencer, Brian Kramer Roger Phillips, John Comrie; IPSCO Inc. George Rosenau, Leona Bishop; S.G.E.U. Larry Brown, N.U.P.G.E. Alfred Wagner, Jackie Thomas, Glen Scheuer Al McDougall, Nesbitt Thompson Brian Illerbrun Bill Klempp Sylvia Kish, Bob Finlay; Sask Chamber of Commerce Bob Rempel Don McGregor
Thursday, August 24	Regina	Paul Haddow, Bob Richards, Bob Perrin, Bob Donald; Department of Trade & Commerce Roger Phillips, Wally Blaisdell; Institute for Saskatchewan Enterprise Wes Norheim, Canadian Labour Congress Ted Cholod, Jim Warren, Mervin Norton; SUMA Don Geesen, Kalium Chemicals Ken Plante Gord Murray, Citizens Against Privatization Brian Kinder, Rod Gessell; Regina Chamber of Commerce Ervin Wolfe, Sr. Dale Baldwin
Friday, August 25	Regina	Margaret Crowle, Consumers Association

		Kevin Avran, Saskatchewan Taxpayers Gordon MacMurchy, Family Farm Association Bob Hill Doug Emsley, SabreWest Oil & Gas Ltd. Tom Waller Hugh Wagner, Walter Eberle; Grain Services Union Vonda Kosloski; Committee to Protect he Family Maryann Gerard Robert Patton
Wednesday, August 30	Saskatoon	Mayor Henry Dayday, Phil Richards; City of Saskatoon Peter Perdue, Bruce Hilland; Toronto Dominion Securities Ian McNabb, Canadian Gas Association Henry Feldkamp John Hart Rusty Chartier R. J. Liptrap, Du Pont Canada Merv Harrison, United Church of Canada Dan Wicks, Saskatoon Minor Hockey Association Terry Alm Charles Winograd, Bill Copland, Peter Nares; Richardson Greenshields
Thursday, August 31	Saskatoon	Wes Robbins Eileen Stone Randy Nelson Arvo Raidal P. Hebb, W. DeRoche; Central Guaranty Trust Rev. Hetherington Bill Macza Steve Bobiash, Scott Queenback; Saskatchewan Young New Democrats Corey Olynik, P.C. Party Messrs. Woloshyn & Cline

		Davis; McKercher, McKercher, Laing & Whitmore Keith Hanson Herb Pinder Ed King, Tom Woods, John Griener; Wood Gundy Limited Jim Robbins Messrs. Danychuk & Lappin Sask. Surface Rights
Friday, September 1	Saskatoon	Terry Crush, Bill Cruczko, Tom Lamont; Sask Surface Rights Association Len McCurdy, Peter Ross; Westbridge Computer Corporation Joan Baron Trent Webster, P.C. Youth Federation Dr. Campbell Watkins, Datametrics
Monday, September 18	Regina	Lloyd Rogers, Henry Lorenzen; Energy Management Task Force Robert Patton A. Taylor J. Elfenbaum

APPENDIX A9

KPMG Peat Marwick

Report to the

Barber Commission

Analysis of the Proposed Regulation of TransGas Limited and Provincial Gas Limited

September 1989

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Barber Commission

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- British Columbia Utilities Commission
- Alberta Public Utilities Board
- Ontario Energy Board

I: Introduction

Peat Marwick Consulting Group was engaged by the Barber Commission to analyze and report on the regulatory arrangements proposed for TransGas Limited (hereafter also "TGL") in the Saskatchewan Energy Corporation Act, (Bill No.22) (hereafter also "SEC Act"), and for Provincial Gas Limited (hereafter also "PGL") in the Distribution of Gas Rate Regulation Act, (Bill No. 23) (hereafter also "DGRR Act").

Under the Terms of Reference for this engagement, our analysis focused on the following:

- A review of the current regulatory structures and approaches for public utilities in Canada;
- Analysis and comments on the specific provisions in the proposed legislation for the regulation of TransGas Limited and Provincial Gas Limited, and conclusions as to the overall appropriateness of the proposed regulatory mechanisms.

Our review did not include a detailed analysis of the issues which would likely be addressed by regulators of these utilities or the appropriate regulatory decisions in regard to these issues. In our opinion, these matters should be addressed by the regulators of these utilities in the course of regulatory hearings and deliberations, and are not germane to the review of the overall regulatory arrangements proposed in the legislation.

The report on this engagement is structured as follows:

I Introduction

II Regulation of Public Utilities in Canada

III Proposed Regulation of Provincial Gas Limited

IV Proposed Regulation of TransGas Limited

V Conclusions

Appendix I - Highlights of the Regulatory Authority and Procedures of:

- British Columbia Utilities Commission
- Alberta Public Utilities Board
- Ontario Energy Board

II: Regulation Of Public Utilities In Canada

Most Public Utilities In Canada Are Rate Regulated

There is a strong regulatory tradition in Canada, and indeed throughout North America. With the exception of some municipally-owned utilities, most of the major electric, telephone, and gas utilities in Canada are or will be regulated.

However, there are significant differences in the powers and authority of the regulators of these utilities. Appendix I to this Report provides details of the differences in the regulatory authority and procedures of the British Columbia Utilities Commission, the Alberta Public Utilities Board, and the Ontario Energy Board.

The major differences in the authority of regulators in Canada pertain to their authority to be the final determinator of rates to be charged by a utility and their authority to review, amend, and approve capital spending programs of the utilities they regulate. The most notable difference is the authority of the Ontario Energy Board to review but not act as the final determinator of the rates of Ontario Hydro, the government-owned electric utility in that province. The Ontario Energy Board makes recommendations to the Minister of Energy upon the conclusion of its hearings into the rates of Ontario Hydro. Ontario Hydro then acts as the final determinator of rates to be charged to consumers. The Ontario Energy Board has no authority to amend the capital spending programs of Ontario Hydro, or the timing of or spending of those programs, notwithstanding the authority of the OEB to conduct hearings into the economics and prudence of Ontario Hydro's spending program.

The major utilities in Canada for which there is no final regulatory determination of the rates to be charged are all government-owned utilities. While the issue of whether or not an independent regulator should set rates for government-owned utilities is a complex issue, the arguments come down to the following questions:

- In as much as government-owned utilities have the benefit of government guarantees of their debt, should Governments be the final determinator of financing plans, capital spending, and the setting of rates to consumers?
- Because these utilities are "owned" by the people within a jurisdiction, should the Government, acting on behalf of the people, be the final determinator of the appropriate rates and financing plans?
- Inasmuch as utilities are providers of essential services and infrastructure for social and economic policy, should not Government have the declared and open authority to influence the development of this infrastructure to meet the social and economic goals of the jurisdiction?

The last point warrants further discussion, in terms of the responsibilities of a monopoly position of a utility.

The Monopoly Position Of A Utility Carries Constraints And Responsibilities

Regulatory theory and practice suggest that one of the responsibilities of a monopoly utility is to progress toward the provision of essential utility services to all consumers within the territory in which it provides services. A utility is not able to ignore its monopoly position and the responsibilities to provide essential service within the territory, in favour of selecting the specific customers or the parts of the territory to which it wishes to provide service. Given the essential nature of the services which a utility provides, it is incumbent on the utility to develop capital expansion and service plans which will bring about universal service to all customers in that territory. This is a longstanding regulatory principle, referred to in some legislation as the "obligation to provide service".

Notwithstanding this principle, its application does not require that a utility undertake immediately the provision of services to all customers within its territory. Such action may be financially imprudent for the utility and could jeopardize its ability to remain viable and, potentially, to provide service within the prescribed territory. The shared responsibility of a utility and the regulator of a utility is to ensure that plans and programs are set in place that will progress towards universal service at a pace and at a level of financing which will ensure the viability of the utility and reasonableness of rates to existing ratepayers.

It is also a responsibility of a utility and its regulator to specify the conditions of the provision of service, such as a requirement that some customers must pay a contribution charge to partially or fully offset the cost of capital equipment to provide service to them. Moreover, a regulator normally determines the accounting treatment of these contribution charges. These conditions of service are either specified in the utility legislation or are set as regulations under the legislation by the regulatory authority.

One of the major issues which regulators face in assessing capital expansion programs of utilities is the review of the economics of capital spending decisions on utility plant. A regulator normally reviews capital expansion programs to ensure that the economics of a planned capital addition are: (1) not contrary to the overall financial viability of the utility; (2) are consistent with the utility's responsibility as a monopoly provider of services to move towards universal service; and (3) are not unreasonably onerous in terms of their implication for rates to be paid by existing ratepayers.

Most regulators review the economics of capital spending programs not just in terms of the short term economics of the spending but also in the context of the requirement for universal service and a requirement that the resulting rates for services to all customers are just and reasonable. This is very much a decision based on judgement more than mere calculations. In the exercise of this judgement, regulators frequently assess whether the utility has been unduly influenced by governments to accelerate or extend its capital spending programs in ways which would cause the resulting rates to all consumers not to be just and reasonable. In this regard, regulators may protect the utility from such undue pressure and, thereby, protect the interest of the utility, its subscribers, and its creditors and investors.

The implicit responsibility of the regulator of a utility is to achieve a fair and reasonable balance among the interests of: (1) the utility as an entity charged with the responsibility to provide service; (2) the consumers of those services within the territory of the utility; (3) the investors and lenders of funds to the utility; (4) the public policy interest of the Government in ensuring that essential infrastructure services are available at reasonable cost to potential customers within its jurisdiction. In some respects, these interests are identical. All of the four parties have an interest in ensuring that the utility remains financially viable and well managed. However, each party has its specific interests which it wishes to be well served. Customers prefer service availability, on demand, at reasonable rates. A utility seeks to have the financial flexibility to secure financing whenever it has a need to, and to effect rate changes on a timely basis. Investors and lenders of funds have an interest in protecting their financial relationship with the utility and the funds which they have entrusted to it. The government, through public policy, sees utility services as essential in economic development and the achievement of social policy objectives.

The role of the regulator is to strike a balance among these interests, by ensuring that rates are just and reasonable, and fair and non-discriminatory among classes of customers.

If proposed regulatory arrangements for TGL and PGL do not enable the regulators to achieve this balance, then there is the serious risk that the regulatory arrangements may be called into question, may not be seen as fair, and ultimately may prove dysfunctional for the interested parties. The review of the specific revisions of the proposed regulatory arrangements for TGL and PGL are tested against this requirement.

The Fairness Principle And Cost Based Rates

Most regulators apply the test of fairness in terms of costs of service to classes of customers. They seek to ensure that there is a reasonable correlation between the cost allocated to specific classes of customers and the rates that are charged to those customers. The regulator will ensure that there are sufficient distinctions between classes or services, and that rates for each class of service are reasonably related to the allocation of costs to those classes of service.

Moreover, regulators are normally empowered to ensure that there are no inequities in the allocation of these costs between time periods, such as when customers of one time period are charged rates which reflect costs of a prior or future time period. Regulatory tribunals, which are empowered to set rates, use a test year in determining the appropriate costs to be recovered in the rates.

This issue becomes complicated because utilities must base their charges to customers on their best estimates and forecast of the costs that will pertain to the period for which the rates will apply. In the event that the actual costs exceed these estimates and forecasts, fairness to customers dictates that only some of these excess costs may be recovered by the utility through amended rates.

A gas distribution utility will normally incur costs of gas and transmission costs charged to it by a transmission utility which are "non-controllable" costs to the distribution utility at the time that the estimates of cost of service are determined. Accordingly, regulators of gas utilities permit the flowthrough of the differences between forecasts and actual costs of supply of gas and transmission expenses.

However, gas distribution utilities are not normally able to recover in current or subsequent time periods the differences between forecasts and actual expenses related to some other costs, such as long-term interest expense or administration costs. Indeed, this is a normal commercial and industrial pricing practice. Companies providing goods and services to consumers are not able to recover through prices after the provision of service the differences between what were forecast to be the costs of the product and what in fact was incurred as the cost of the product. Such differences are considered a risk to the owners of the company. The onus for the responsibility for the accuracy of forecasts is placed on the company and not on the consumers of goods and services. The regulatory approach in Canada and in the United States is that the monopoly position of the utility, which requires that customers buy utility services from these companies, should not shift this burden of responsibility.

The setting of a rate structure and the determination of the appropriate classes of customers of a utility involve not only complex engineering and accounting allocations, but also the exercise of judgement by the regulator. The setting of classes of service requires that a regulator determine which customers have similarities in their demand for service and in the cost structure of providing service to them. For different classes of customer there are major differences in the demand requirements and the attribution of cost. The regulatory principle is that one customer within a class of customers in a specific geographic zone should not be advantaged or disadvantaged in comparison to another customer in that same class on the basis of how close the customer is to the gas distribution line or the transmission line which supplies the gas.

The exception to this would be the requirement for customer contributions from a customer which is far removed from the line of supply.

The rules and requirements pertaining to customer contributions are normally embodied in the utility legislation or included as regulations under the legislation set by a regulator.

One of the guiding principles of utility regulation in North America is that the return to the owners of the utility should be based on the assets of the utility.

In general terms, the rate base of a utility is a valuation of the assets of the utility which are used and useful in the provision of utility services. The precise calculation of rate base varies among the regulatory agencies and has been the subject of considerable regulatory analysis and judicial interpretation for decades in North America. The issues pertain not only to the appropriate inclusions in a rate base but how the rate base should be valued. Typically, a rate base includes a valuation of the plant assets related to the provision of service, an allowance for working capital, and treatment of any deferred charges which the utility may have incurred.

The issue of the appropriate valuation of rate base assets includes considerations relating to the transfer of assets from one utility to another. However, the precise determination of the rate base of TGL and PGL is a matter of concern for the regulators of these utilities.

What is germane to the consideration of the appropriate regulation of TGL and PGL is whether each regulator should be empowered to determine the rate base of these utilities or whether the regulator should be authorized only to approve additions to the rate base in place prior to regulation.

Most regulators of major utilities in Canada are authorized to set or determine the rate bases of utilities, for the purpose of determining a fair return on those assets. The Appendix to this Report documents the specific provisions in selected regulatory legislation. The normal authority of a regulator to determine or set the rate base is based on the concept that the regulator must make judgements as to the appropriate inclusions in the rate base, usually in terms of which utility assets are used in the provision of the utility services and which assets pertain to the non-utility services of the utility company. Moreover, regulators look for the exercise of financial prudence by the utility in the construction or purchase of rate base assets.

The provisions under the proposed legislation that the regulators of both TGL and PGL may only approve additions to the rate base are not consistent with prevailing regulation in Canada. These provisions would not enable the regulators to review the overall composition and valuation of the rate base of each utility at a specific time.

The rate base concept is critical to effective regulation, inasmuch as the determination and valuation of utility assets and services dictates the basis for depreciation charges and the allocation of financing charges to the acquisition of utility assets.

In setting a return on the rate base, most legislation requires a regulator to set a "fair return" or "reasonable rate" of return on rate base. The provisions in the DGRR Act and the SEC Act require the regulators of PGL and TGL to set "just and reasonable" returns on rate base. These provisions are entirely consistent with regulatory principles and the prevailing legislative requirements in other jurisdictions.

In summary on this issue of rate base regulation, the most troublesome aspect of the proposed regulation of TGL and PGL is the limitation of the authority of the regulators of TGL and PGL to approve only additions to rate base.

Transition Arrangements Prior To Regulation

The SEC Act provides for the regulation of TGL in 1991. The DGRR Act provides for independent regulation beginning in 1992. Prior to those dates, the Lieutenant Governor in Council will determine the rate base of both TGL and PGL, and the classes of service and rate design.

The precedent for the use of a transition period prior to regulation of a utility is the use of a transition period subsequent to the sale of Mainland Gas Company, the gas distribution division of B.C. Hydro, to Inland Natural Gas, the gas distributor for the interior of British Columbia. A new gas distribution utility was created, B.C. Gas, which was placed under the regulatory authority of the British Columbia Utilities Commission, subsequent to a transition period. The transition period for the regulation of B.C. Gas has not yet expired. In discussions with officials of the B.C. Utilities Commission, they disclosed that the Commission currently acts on behalf of the Lieutenant Governor in Council as the "informal" regulator of B.C. Gas.

Accordingly, there is a Canadian precedent for and there is nothing inherently inappropriate in the proposed transition arrangements for the regulation of both TGL and PGL. However, a bondholder or investor in SaskEnergy may well have a concern that the absence of a formal, external, independent regulatory review may make the utility vulnerable to undue political influence during the transition period in areas such as rate base asset additions. Moreover, when regulation does come into effect, the regulators of TGL and PGL are not authorized to amend the rate bases constructed during the transition period. The gas consumers in Saskatchewan may have similar concerns.

This point is raised solely to reinforce the point that it is most often in the best interest of the utility, its customers and those who have provided financing to the utility to have effective regulation of the utility by an independent external tribunal. Bond rating agencies and investment dealers analyze the degree and the effectiveness of regulation of a utility, regardless of whether it is government-owned or investor-owned.

They measure "regulatory risk" to a utility as one factor in the assessment of the quality of a utility's bond or share. One test they consider is whether the utility is explicitly regulated and effectively regulated, so as to reduce the financial uncertainties to the utility which may arise from excessive public policy influence and the inability of the utility to recover its cost of service and the cost of its capital construction program.

On this basis, the merits of the transition period should be reassessed.

The Efficiency Of The Regulatory Process

There is a serious concern among utilities, lenders of funds and investors, and, indeed, the public in some jurisdictions in Canada that the regulatory processes in place within those jurisdictions have become ineffective. The concerns are based primarily on what is called "regulatory lag", which is the delay in receiving regulatory approval of rates subsequent to the application for changes in those rates by the utility. The major causes of regulatory lag are: (1) an extension by some regulators of their authority to review capital expansion programs into the realm of public policy, (2) the deterioration of the relationships between utilities and their regulators resulting in unresolvable stalemates in regulatory demands for critical information, and (3) the intervention by large numbers of interested parties in hearings, resulting in prolonged hearing times and costs.

Regulatory lag threatens the financial viability of utilities. It requires the use of enormous financial and management resources of the utilities to obtain rate change approvals. In extreme situations, regulatory lags have resulted in the impairment of the financial viability of utilities and, in several cases, the business failure of utilities. Needless to say, excessive regulatory lag is contrary to the best interest of all parties in the process.

The problems of regulatory lag are far more severe and pervasive in the United States than they are in Canada. However, it is fair to state that the time involved in the regulatory process for the conduct of hearings and rendering of decisions on rate changes is greater in Canada now than it was fifteen years ago. However, the time differences in Canada can be expressed in terms of several months, whereas regulatory lág in the United States has resulted in delays of several years.

There are several regulatory approaches which have been employed in Canada and in the United States to attempt to reduce regulatory lag and achieve a more effective regulatory process. A few of these are :

- The use of "price cap" rate-making whereby a regulator establishes the fair return and other costs of services for a utility for a prescribed period and then sets a maximum rate for charges to customers. If the utility is able to achieve a greater return on its common equity than that prescribed in the rate decision, it is able to keep the difference without having to undergo a subsequent regulatory review. In effect, the concept of a "price cap" is to encourage and not penalize a utility for being efficient and effective in its planning and use of resources, while at the same time providing rate stability to its customers.

- Use of a range of returns on capital in determining the return on rate base, so that any returns earned by the utility within that range are allowed.

- The use of policy directives by governments to regulators to inform regulators of the policy objectives and intentions of the government on matters which pertain to the availability of utility services within the jurisdiction. The British Columbia Utilities Commission Act provides for the use of policy directives by the Government to the British Columbia Utilities Commission.

- The use of pre-hearing conferences on the issues within the scope of a hearing and the authority of a regulator to set and limit the issues to be addressed in a specific hearing. This authority enables a regulator to restrict the scope of a hearing and to reduce the risk that the rate hearing will drift into broader discussions of capital planning or costing and pricing philosophy which could better be addressed within the scope of a separate "generic hearing" in which specific rate increases are not under review.

The proposed regulatory arrangements for TGL and PGL have been designed to ensure that the regulatory process is efficient, and will reduce the regulatory risk to the utilities. The proposed approach would achieve this by restricting regulatory authority and by limiting the review process.

This report recommends changes in the proposed regulation of TGL and PGL which would balance regulatory efficiency with regulatory effectiveness. The recommendations for change would reduce the restrictions of regulatory authority and the review process.

III: Proposed Regulation Of Provincial Gas Limited

Overview

The Bill to enact the Distribution of Gas Rate Regulation Act provides for the appointment of a Saskatchewan Gas Regulation Commissioner (hereafter "the Commissioner") for a ten year period with specific but limited authority pertaining to the rates and revenues of Provincial Gas Limited. The Commissioner is appointed for a ten year period which may be renewed for a further ten year period by the Lieutenant Governor in Council. The Commissioner would act as the sole regulator of PGL, and is authorized to employ only a secretary. The Commissioner is empowered to retain experts and advisors as considered necessary.

Under the DGRR Act, PGL would set its own schedule of rates. Upon an application by a customer (or other interested party) or on his/her own initiative, the Gas Commissioner may order a hearing on the rates already in effect. The Commissioner may only order a rate review once in every three year period, which is known as the "review period". If the Commissioner should vary the rate schedule of PGL upon holding a hearing, the revised rates would remain in effect only for the twelve month period for which PGL had originally intended these rates to apply.

For the remaining two years, PGL may amend its rates annually, without any rate review, using a formula prescribed in the DGRR Act for the calculation of Allowed Revenue. The Gas Commissioner is authorized:

(1) to confirm that the calculation of Allowed Revenue complies with the prescribed formula;

(2) to confirm that the schedule of rates and the load forecast will yield the Allowed Revenue.

The legislation does not prescribe the rate structures or the conditions of service to be followed by PGL in setting its rates, nor does it empower the Gas Commissioner to prescribe rate structures or conditions of service.

The scope of a hearing ordered by the Gas Commissioner is limited to:

- Setting the return on rate base for PGL for the term of the review period;
- Reviewing Allowed Controllable Costs, as defined in the legislation;
- Reviewing Allowed Non-Controllable Costs of PGL which do not relate to regulated services;
- Calculating the revenue requirement of PGL for the twelve month period under review;
- Approving additions only to PGL rate base;
- Determining the load forecast of PGL for the twelve month period;
- Varying the schedule of rates already in effect.

The Gas Commissioner is specifically precluded under the DGRR Act from reviewing:

- the interest expense of PGL during the review period;
- the dividends to shareholders of PGL;

- the debt instrument costs of PGL;
- depreciation charges of PGL during the review period;
- the cost of gas to PGL;
- the gas transportation, compression, storage, and similar costs;
- taxes, levies, and franchise fees.

The Gas Commissioner also does not have the authority under the legislation to review the following:

- deletions from rate base or the initial valuation of the rate base upon the transfer of assets from SaskPower;
- determination of the appropriate capital structure of PGL for rate making purposes;
- capital spending programs;
- depreciation rates, except once every ten years.

The DGRR Act is silent as to the authority of the Gas Commissioner to review the following:

- the rate structure or the rate philosophy of PGL;
- the regulations or conditions of service to customers of PGL, addressing matters such as circumstances requiring customer contributions, billing or collection practices, service discontinuation procedures, etc.

Upon the conclusion of a hearing, the Gas Commissioner may order that PGL amend its rate structure. Rates as amended by PGL are only in effect for the twelve month period for which the original rates were intended to apply.

PGL may amend its rate structure for new rates at any time for a new industrial customer. The Gas Commissioner may hold a hearing into these rates under the procedures described in the Act, unless the Board has already held a hearing during the same three year review period. The legislation would preclude the Gas Commissioner from holding a hearing into these rates or a hearing on already existing rates if a hearing had already been held during the same three year period.

If the Gas Commissioner amends the rate schedule of PGL as a result of a hearing, any overcharge of customers of PGL will be refunded by PGL to its customers. If the customers have been undercharged as a result of the revised rates, the revenue deficiency from the bills to date is credited to a deferred rebate account.

In the two years subsequent to the year in which a hearing takes place, during which there is no authority for the Gas Commissioner to hold another hearing, the balance in the deferred rebate account is included in the Allowed Revenue calculation, by a formula outlined in the schedule to the legislation. The Allowed Revenue calculation is the determination of the revenue requirement of PGL in each of those two years, which is the basis for the determination of the actual rates.

Analysis Of The Proposed Regulatory Arrangements For PGL

"File And Use" Rate Changes

The proposed arrangements for the review of the rates of PGL is not rate regulation as it is exercised in most jurisdictions in Canada. The typical regulatory authority in Canada includes the authority to set rates, to review all components of revenue requirement, to examine into the rate philosophy of the utility, and to regulate the return on its rate base, using a test year. Typically, the regulator has the authority to order a hearing into rates changes to an existing rate structure when they are proposed.

The Gas Commissioner would act as a reviewer of the rates of PGL and not as the determinator of rates. The responsibility to set rates rests with PGL itself. The proposed arrangements for the review of rates of PGL is essentially a "file and use" system, whereby the utility sets its own rates, and is authorized to put those rates into effect upon filing the rates with the Gas Commissioner. The Gas Commissioner is empowered to confirm on an annual basis that the proposed rates would generate the revenues in accordance with the allowed revenue calculation and to review the load forecast. However, the Gas Commissioner does not set rates. Even in the rate review year, which can be no more than one of every three years, the Gas Commissioner has a broader scope of review, but is still not empowered to set or alter the rates proposed by PGL. In that year, PGL would recalculate the allowed revenue for the rate review year and would file a revised schedule of rates with the Gas Commissioner.

In effect, the Gas Commissioner is placed in a reactive role in the monitoring of rate changes.

A file and use system has precedent in Canada in those jurisdictions which regulate automobile insurance and retail gasoline pricing. As part of a broader regulatory authority of the Gas Commissioner, a file and use system would result in effective regulation of PGL.

Review Of Controllable Costs

The DGRR Act gives the Gas Commissioner very limited scope of review of the costs of PGL, once every three years. In a rate review year, the Gas Commissioner would determine the allowed return on the common shareholders' equity, and the allowed controllable costs of the corporation. The "controllable costs" would include administration costs, customer service and marketing costs, and operations and maintenance costs of PGL. This is a very limited authority to review the costs of service of PGL. Most regulators of gas distribution utilities are authorized to review all costs of service of a utility. The BC Utilities Commission, the Alberta Public Utilities Board, and the Ontario Energy Board all have this authority.

The apparent intent of this limited authority of the Gas Commissioner is to place under regulatory review only those costs incurred by PGL which are under the direct control of PGL.

However, a broader definition of controllable costs should be included within the scope of the authority of the Gas Commissioner, including interest costs (other than short-term interest) or differences in depreciation expense caused by timing differences in the placing of facilities in or out of service during a twelve month period. These costs are currently included in the correction factor, discussed below, but should more appropriately be included in the authority of review by the Gas Commissioner.

Use Of The Correction Factor

The DGRR Act provides for the use of the "correction" of cost differences between forecast costs pertaining to two years prior and actual costs incurred during that same prior year. Under the proposed legislation, PGL is authorized to include in its allowed revenues in the two years after the year in which differences occur, a "correction" factor for this difference. The specifics of this calculation are noted below. The concept of the use of a "correction" should first be examined.

The concept of the "correction" should be distinguished from a flowthrough for non-controllables. Most gas distribution utilities are enabled by legislation or their regulator to flow through certain cost differences, over which they have no control, which may be different from those forecast by the utilitity in its application to a regulator for rate changes. The case of Northwestern Utilities Limited ("NUL") illustrates the flowthrough provisions in place for that utility in the province of Alberta. Northwestern Utilities is a natural gas distribution utility generally serving the city of Edmonton and the northern portion of the province of Alberta. It is regulated by the Public Utilities Board of the Province of Alberta ("the Alberta PUB").

In a recent rate decision, the Alberta PUB reaffirmed its previous decision that the gas cost component of the sales rates of NUL were to be recovered and reconciled through the deferred gas accounting ("DGA") and the reconciliation procedures as previously approved by the Board. The fundamental reason the DGA proposal was originally brought forward by NUL was stated as being the uncertainty in forecasting prices for natural gas as a result of deregulation. Prior to deregulation of natural gas commodity prices, the Alberta gas distributors obtained a majority of their natural gas supplies at prescribed prices under long-term contracts. Deregulation has taken away the certainty which previously existed. Indeed, at present, prices are generally rising and the need for a recovery mechanism for increased natural gas commodity acquisition costs is therefore necessary from the perspective of a regulated gas distribution utility.

The regulatory decision of the Alberta PUB sets out the detailed operation of the mechanism by which the differences between forecast and actual cost of gas may flow through to the rates charged by the utility. Provision is made for interim adjustments in the gas cost recovery rate in the event that unduly large positive or negative variances accumulate.

However, the system does not take away the Alberta PUB residual jurisdiction to disallow the recovery of cost in the event it is found that it has not been prudently incurred.

The approach to the use of flowthrough accounts is different in the Province of Ontario. The Ontario Energy Board has often repeated its general regulatory policy not to approve the setup of deferral accounts. Such accounts are viewed by the OEB as being inconsistent with the regulatory objectives of certainty and providing appropriate signals to the regulated utility to seek to minimize its cost. However, the OEB has been willing to allow the use of such accounts where uncertainty prevails to a greater degree than normal. In a recent decision of the Ontario Energy Board, on the request of Consumers Gas, the Board found that there was sufficient uncertainty existing to justify acceptance of the company's proposal to set up a 1989 purchased gas variation account.

In summary, in most jurisdictions which regulate gas distribution utilities, regulatory opinion is currently in favour of the operation of deferral accounts for the recovery by a regulated utility of gas commodity costs included in its sales rates.

However, the proposed "correction" factor for PGL is intended to include in the revenue requirement in subsequent years a correction for not only cost differences pertaining to the cost of gas but also costs related to:

- taxes and levies;
- interest expense;
- transmission cost;
- depreciation charges;
- certain controllable costs related to regulated services.

The effect of this provision for the "correction" of a broad range of costs and balance sheet changes in years other than the years of rate review is to provide for an automatic flow-through of cost differences except for those costs which are reviewable by the Gas Commissioner, regardless of the cause of differences between the forecast and the actual cost.

If management were to make questionable decisions, or if interest rates were to vary significantly from those forecast by the utility, the differences would be included in the correction factor. This provision reduces the regulatory and financial risks to the utility, with the full financial impact on rates borne by its customers.

It is reasonable that PGL be permitted to flow through costs of gas and related transmission costs, but not differences related to long-term interest expense or some differences in depreciation charges.

It is also appropriate, as in the case of Northwestern Utilities Limited cited above, that the Gas Commissioner have the residual jurisdiction to disallow the recovery of costs in the event that they have not been prudently incurred.

These two changes would result in more effective regulation and the achievement of a better balance between the utility's and the customers' interests.

Consumer Price Index Basis For Allowable Costs

In those years other than the rate review years, PGL may include in its Allowed Revenue a provision for controllable costs which may include an inflation factor based on the Consumer Price Index (CPI). For example, PGL would be allowed to increase its Controllable Costs in these years by up to 5% if the Consumer Price Index increased at that rate during that period.

Such a provision is seen by PGL as a means to control the level of spending on costs within its own discretion. Critics of the use of a CPI factor contend that it provides a licence to the utility to increase some costs arbitrarily up to the inflation level. In reality, the achievement of annual cost increases which do not exceed the rate of inflation is a suffiently difficult target for utilities that this provision will likely limit the cost increases to be borne by the customer.

The use of a CPI provision is an interesting and innovative approach to controlling the costs incurred by a utility. It will likely serve to the best advantage of both the utility and its customers.

Prescribing The Rate Base At December 31, 1988

DGRR Act enables the Lieutenant Governor in Council to make regulations which would prescribe the rate base as at December 31, 1988 and any additions to the rate base for the base year and each of the two years immediately following this year.

A critical issue to be considered by the Lieutenant Governor in Council at the time of prescribing the initial rate base of PGL in 1988 is the appropriate transfer price of the assets acquired by Sask Energy from Sask Power.

The prevailing regulatory approach in Canada to the transfer of utility assets from one utility to another is to transfer those assets to the rate base of the acquiring utility at their depreciated, historical cost. The purpose of this provision is to ensure that the customers of the utility acquiring the assets are not required to pay more than once for the same assets which are used in the provision of services to these customers. If these assets were included in the acquiring utility's rate base at a valuation greater than their historical cost, the customers would be paying twice through rate base returns and depreciation expenses.

It is essential to note that these regulatory decisions and approaches did not contemplate the privatization of a utility and the requirement to value the assets of a privatized utility at their market value. Prospective shareholders of a privatized utility would reasonably expect that the "new" utility would value the utility assets on its balance sheet and in its rate base at the valuation transfer price.

The issue of the valuation of transferred assets is complicated by the fact that transfer proceeds in excess of the historic depreciated cost of the transferred assets would benefit the customers of SaskPower as a group. This group of electricity consumers corresponds roughly with the gas ratepayers as a group.

Accordingly, an important issue to be addressed in prescribing the rate base at December 31, 1988 is whether all utility assets of PGL should be valued for rate-making purposes at the same value at which they are included in the balance sheet of the new utility.

Determination Of Rate Base And Return On Rate Base

The DGRR Act enables the Gas Commissioner to review proposed additions to the fixed assets in the rate base, where the proposed addition is considered prudent. Moreover, the legislation requires the Commissioner to approve an addition to the rate base that the Lieutenant Government in Council directs the corporation to undertake.

The first provision for the approval of additions to rate base does not enable the Commissioner to approve the proposed deductions from rate base or to disallow specific assets from inclusion in rate base. Deductions from rate base would pertain to utility assets which are no longer in service, and should not be included in the "used and useful" rate base. The disallowance of assets from the rate base often pertains to an investment by a utility in assets which are used for unregulated activities. The provision in the DGRR Act is unduly restrictive and is not in keeping with the prevailing regulatory approach to the determination of a rate base of the utility.

A more appropriate provision would be the requirement that PGL file its estimate of rate base prior to the beginning of the period in which new rates are intended to go into effect. The Gas Commissioner would review the proposed additions and deletions to rate base at their estimated cost. At the conclusion of the year, PGL would file its actual rate base additions and deletions for the same period, for subsequent approval by the Gas Commissioner. The effect of this provision would be to permit PGL to base its rates on the estimated changes to rate base, while requiring final regulatory approval of the actual costs incurred for rate base changes.

The intended provisions of the DGRR Act to limit the scope of rate base review by the Gas Commissioner to only changes subsequent to the completion of the Gas Distribution Program could still be continued. The authority of the

Gas Commissioner would relate only to additions and deletions and disallowances of assets subsequent to those in place at December 31, 1988 and those subsequently incurred as directed by the Lieutenant Governor in Council.

Determination Of The Rate Of Return On Common Equity

One of the major considerations in the determination of the appropriate return on the rate base of a utility is the determination of the required return on the capital structure of the utility, including its equity components.

The DGRR Act enables the Lieutenant Governor in Council to prescribe the allowed return on the common shareholders' equity for the base year and each of the two years immediately following the base year, which is the transition period prior to rate review.

Subsequently, in approving a return on the common shareholders' equity of the utility, the Gas Commissioner is required:

(1) to approve a return which will produce rates which will "ensure the financial viability of the corporation's operations relating to the provision of regulated services..."; and

(2) to consider, as one of the number of factors, the comparable returns on common shareholders' equity allowed to other, similar utilities.

The first requirement that the Gas Commissioner ensure the financial viability of PGL operations is an unreasonable responsibility to place on the Gas Commissioner. Notwithstanding the appropriateness of the return on rate base set by the Gas Commissioner, the Gas Commissioner is not in a position to ensure that PGL will subsequently be able to earn this return. Gas volumes may change, economic circumstances may change, and the ability to ensure the financial viability of PGL is not within the control of PGL or the Gas

Commissioner. It would be more appropriate to require the Gas Commissioner to set rates which would give PGL an opportunity to earn a fair return on its rate base. This is more appropriate terminology for the legislation and a more appropriate burden of responsibility on the regulator.

The comparable earnings test prescribed in the legislation is a reasonable factor for the Gas Commissioner to consider, among other factors. The comparable earnings test is one of a number of return on capital methodologies in use in Canada. Other methodologies include the "capital attraction" test and the "dividend yield plus growth" approach.

It is appropriate to include reference to the comparable earnings test in the legislation, although the reference to comparability of earnings during the two years preceding the rate review year may be a misleading signal to the Gas Commissioner. The deficiency of this requirement is that financial markets and the economy in general in Canada may change during a two-year period, such that the use of allowed returns of preceding years may not accurately reflect the prevailing market requirements at the time the determination must be made.

Nonetheless, the comparable earnings approach is intended to be only one of a number of considerations by the Gas Commissioner in the determination of a "just and reasonable" return on common shareholders' equity. The overall requirement of the Gas Commissioner is reasonable.

Terms And Conditions Of The Appointment Of The Gas Commissioner

Ten-Year Renewable Term

Section 3 of Part II of the DGRR Act provides for a ten-year, renewable term of the Gas Commissioner. While this is an unusually long term by Canadian regulatory standards, it is an acceptable term. Indeed, the length of the term may well highlight the intended independence of the Gas Commissioner.

Gas Commissioner To Employ Only A Secretary

Section 5(1)(a) of Part II provides that the Gas Commissioner may employ only a secretary. The Bill also provides that the Commissioner may appoint experts or persons having special technical knowledge.

Most regulatory agencies in Canada employ office, technical, and advisory staff. While the periodic review to be undertaken by the Gas Commissioner would have the effect of reducing the administrative workload of the Commissioner's Office, it is unreasonable to require legislative approval if the Gas Commissioner seeks to hire clerical or full-time advisory staff.

It is recommended that this provision of the draft legislation be reviewed.

Appointment Of Only One Gas Commissioner

Section 3(1) of Part II the DGRR Act provides for the appointment by the Lieutenant Governor in Council of only one person to serve as the Gas Commissioner.

The apparent trade-off here is the cost of the Office of the Gas Commissioner and the cost of rate review hearings with the effectiveness of the process and the appearance of independence of the rate reviewer.

During the course of a hearing, a single Commissioner would not have the benefit of the opinions of other members of a hearing panel, and the advantage of multiple views in the post-hearing deliberations. After a hearing, there are great demands on a regulator to analyze submissions and to formulate a decision, and then to write a decision, if required.

Moreover, there is the risk of losing continuity of knowledge and experience on utility issues at the end of the Commissioner's term if there is only one Commissioner. There may also be the risk of a public perception over time of a loss of independence by a single Commissioner, because there are not multiple views on the hearing panel. Either situation would be contrary to the interests of the utility, its customers, and the Government.

In the interest of achieving a balance between economy and effectiveness, this provision of the DGRR Act should be reviewed and amended to make possible the appointment of two additional part-time members of the Gas Commission to be involved only during a hearing and in post-hearing deliberations. It should also be required that the Gas Commission render a written decision on each rate hearing.

Authority Of The Gas Commissioner To Set Accounting Policy

The DGRR Act is silent on the authority of the Gas Commissioner to set the accounting policies and rules to be followed by PGL in keeping its accounting records and for reporting its financial information.

It is a standard regulatory requirement that a utility keep its accounting records in accordance with the accounting policies approved by its regulator. While this may appear to be a technical detail, this requirement ensures that the regulator is able to review information between years with the assurance that the information is kept on a consistent basis in accordance with prevailing regulatory accounting treatment.

The Gas Commissioner should have the authority to prescribe and require the compliance with specific accounting policies and procedures.

Regulations Under DGRR Act For Conditions Of Service

The current regulatory practice in Canada is to:

1. authorize a regulator to set the conditions of service by which a utility is required to provide service to its customers; or

2. prescribe these conditions of service in regulations under the prevailing statute.

Such conditions of service would include, among others:

- emergency allocation procedures;
- obligation of the utility to provide service;
- obligation of the utility to provide transportation service;
- right of entry of customer premises;
- power of the utility to disconnect service and require security deposits;
- collection of customer accounts in arrears, etc.

The DGRR Act is silent on the authority of the regulator to prescribe such conditions of service. It may be preferable to outline these conditions of service in regulations under the DGRR Act.

Costs Of The Hearing Process

Section 19 of Part III of the DGRR Act provides that the costs of a hearing shall be borne equally by the Government of Saskatchewan and PGL.

It is presumed that the annual, ongoing salary and administration costs of the office of the Gas Commissioner would be funded by the Government of Saskatchewan in its annual appropriation of General Revenues.

The presumed treatment of the annual costs of the office of the Gas Commissioner is reasonable and has precedent in other jurisdictions.

The DGRR Act is silent on the authority of the Gas Commissioner to award the costs incurred by intervenors in a hearing. Such costs would normally include legal costs, the costs of expert witnesses, and costs of the preparation and filing of evidence by intervenors.

There is no standard regulatory practice or legislative provision in Canada for the awarding of intervenors' costs. The current practices include:

(i) no awards and no legislative provision for awarding costs;

(ii) Government funding of some organizations' costs on an ongoing basis;

(iii) regulatory discretion on the eligibility criteria for awarding costs and the actual amount of awarded costs.

The practice of the Ontario Energy Board in this regard is noteworthy. The OEB has established eligibility criteria for awarding costs, with one criterion being the contribution of an intervenor to a better understanding of the issues within the scope of a hearing. An intervenor must file a reimbursement proposal with the Board, and the Board then assesses the proposal against the eligibility criteria. Intervenors filing such a proposal are also required to file a statement of costs with the Board and the utility. If an intervenor's proposal is accepted by the Board, the Board orders the utility to reimburse a specified portion of the intervenor's costs.

It is recommended that:

(a) the Government of Saskatchewan not bear any of the direct costs of a hearing; and

(b) the regulator of PGL be authorized under the DGRR Act to establish a policy for the award of intervenors' costs related to a hearing.

Is A Separate Regulator Required For PGL?

The position of Gas Commissioner, created under the DGRR Act, is intended to be a regulatory agency separate and distinct from the Oil and Gas Conservation Board (OGCB).

The assumed intention is that the role and level of activity of the Gas Commissioner is so limited that a single individual, operating on a full-time basis, could undertake the duties of this office. The intended result is cost-efficient regulation of PGL.

Nonetheless, there are inherent advantages of having the same regulator for both PGL and TGL, especially in light of the changes to the DGRR Act suggested in this report. A single regulatory agency could develop the competence in utility matters and the continuity on issues affecting these utilities over time. Moreover, a single agency could better regulate the allocation of costs between the two utilities and the resolution of issues pertaining to the transfer of costs from the transmission utility to the distribution utility.

Most important, a single agency with multiple members would have the advantage of multiple views through consultation on an ongoing basis.

The single regulatory agency approach would not necessarily be more expensive. The result could be less expensive than two separate agencies.

The arguments in favour of a single regulatory agency appear to outweigh the intended benefits of cost-efficiency and separation of duties.

Summary

In summary, the analysis of the proposed regulatory arrangements for Provincial Gas Limited recommends the following changes in the regulatory authority and process:

- The Oil and Gas Conservation Board (OGCB) to be the regulator of PGL, with the authority to:
    - Approve the estimated changes to the rate base of PGL prior to the filing of a schedule of rates, and the subsequent approval of the actual rate base changes at the end of the year in which those rates were in effect.
    - Set a just and reasonable return on rate base each year without the responsibility to "ensure the financial viability" of PGL operations.
    - Set the depreciation rates and schedule of depreciation, and to order a depreciation study and hearing at any time.
    - Order a hearing into rates at any time but a hearing would not be a prerequisite for rate changes.
    - Establish a policy for the award of intervenors' costs of a hearing.
    - Review all costs of service at the time of the filing of rates, and provide for normal flowthrough arrangements pertaining to costs of gas and transmittal costs.

  - Set accounting policy, and recommend changes in regulations for the conditions of service by PGL.

  - Hire any staff.

Provincial Gas Limited will have the authority and responsibility to:

- File its intended rates for the upcoming year on an annual basis with the OGCB, together with its rate base estimate for that year and the actual rate base from the prior year.

- Put rates into effect upon filing such rates with the OGCB.

- Use the prescribed formula for Allowed Revenue, and the most recent OGCB determination of rate of return and rate base in years other than a review period.

- The prescribed formula for Allowed Revenue would include a correction factor for transmission costs, costs of gas, and some other non-controllable expenses, but not long-term interest expense or depreciation differences except on approved rate base estimates.

IV: Proposed Regulation Of TransGas Limited

Overview

The Saskatchewan Energy Corporation Act pertains to the rate review of TransGas Limited. The SEC Act empowers the Oil and Gas Conservation Board with rate review authority. The Oil and Gas Conservation Board is created under the Oil and Gas Conservation Act. It is our understanding that the role of the Oil and Gas Conservation Board pertaining to all pipelines in Saskatchewan is under review.

The Oil and Gas Conservation Board is empowered with the following authority over the rates of TGL:

- On complaint by a customer, the Board shall determine the justness and reasonableness of rates set by TGL.
- The Board may vary the rates set by TGL for not longer than a twelve-month period, but not so as to establish classes of rates which are based on the distance that the gas is transported or the point of receipt of the gas.
- The Board shall approve rate base additions, only in response to a complaint or on application by TGL. The Board has ninety days after a hearing or an application to approve these additions; otherwise the additions are deemed to have been approved.
- The Board shall determine once every ten years the schedule for calculation of allowed depreciation, after an initial ten year

period when the Lieutenant Governor in Council shall set that schedule.

It should be noted that this rate review proposal is unlike the DGRR Act arrangement for PGL in that the Board is not specifically precluded from reviewing the component costs of the revenue requirement of TGL.

There is also no restriction on the limitation to one review during a three year review period. The Board could review TGL rates annually or more frequently, if necessary.

There is also no provision for the correction of differences between forecast and actual costs of TGL or for automatic escalators for costs in the years after a rate review.

However, the SEC Act has similar restrictions to the DGRR Act in the authority of the Board in approving rate base additions only. The Board is restricted from approving deletions or disallowing assets. Furthermore, the time limitation of ninety days applies for Board approval of rate base additions to come into effect.

The Board has similar responsibilities to the Gas Commissioner under the DGRR Act to ensure that rates are sufficient to "ensure the financial viability of TGL operations". In doing this, the Board is to consider the comparable earnings of other gas utilities in its assessment of the return on the common equity of TGL.

Comments

The proposed regulatory arrangement for the regulation of TGL is an appropriate arrangement for the regulatory review of contract prices to the customers of TGL. It is expected that TGL will have a limited number of customers (perhaps approximately 200 customers), including PGL and other large industrial and institutional consumers. TGL would establish the rates to be charged to each of these customers. These rates would prevail unless a complaint were lodged initially with TGL itself and, if resolution were not possible between those parties, with the OGCB.

It could be expected that most of the issues pertaining to contract prices between TGL and its customers could be resolved between the companies without the involvement of the Board. This would be the normal course of events for major gas transmission companies in Canada.

In the event that an agreement could not be reached between TGL and a specific customer, the customer could lodge a complaint with the Board which would prompt a review by the Board and, potentially, a hearing. The requirement for a hearing would normally be the exception to the normal course of events.

In essence, rate setting would be a negotiated process between TGL and its customers. Accordingly, the important role of the Board would be in "arbitrating" rate disputes between TGL and its customers.

The deficiencies in the proposed legislation pertain less to the authority of the Board than to the specified requirements by which the Board would exercise its authority. The major deficiencies are:

- The requirement that the Board set rates which are sufficient to "ensure the financial viability" of TGL.
- The limitation on the authority of the Board to only approve additions to rate base, and not disallowances from rate base or deductions for assets no longer in service.
- The requirement that the Board may set a depreciation schedule which must be in effect for a ten year period commencing in the year in which the schedule is made.

All of these deficiencies are deficiencies which also pertain to the regulation of PGL.

In summary, the provisions under the SEC Act for the regulation of TGL are not unreasonable. The regulator's role as "arbitrator" of disputes between TGL and its customers is a common role for regulators of gas transmission companies in Canada.

As noted previously, the regulatory approaches which warrant further review are:

- The limitation on the Board's authority to set depreciation rates every ten years. The Board should have the authority to initiate a depreciation review at any time.
- The requirement of the Board to set rates which will "ensure the financial viability" of TGL should be changed to require the Board to determine that rates are just and reasonable and will give TGL the opportunity to earn a fair return on its common equity.
- The Board should have the authority to prescribe the accounting policies by which TGL will keep its accounting records and disclose its financial results.
- Regulations under the SEC Act should set the conditions of access and service to the customers of TGL.

V: Conclusions

The proposed regulatory arrangements for TGL and PGL appear to have been designed to achieve low-cost, efficient regulation of these two utilities.

The recommended modifications of the regulatory authorities and processes are intended to achieve a better balance among the utilities' interests, the interests of their customers, and public policy objectives.

The proposed regulatory arrangements with respect to **TransGas Limited** would result in regulatory authority and a regulatory process which would be consistent with prevailing gas transmission utility regulation in Canada. The arrangements could be improved, in our opinion, by the following modifications:

- the authority of the Oil and Gas Conservation Board (OGCB) to review depreciation rates and schedules when considered necessary;
- the elimination of the requirement that the OGCB set rates which would "ensure the financial viability" of TGL;
- OGCB Authority to set accounting policies and financial reporting requirements;
- the provision for regulations under the SEC act pertaining to conditions of access and service.

The regulatory proposal for **Provincial Gas Limited** has several regulatory innovations which should be retained:

- a hearing into rates is not a prerequisite for all rate changes;
- PGL would have the authority to set its rates and its regulator would review rate filings on an annual basis, and at other times as considered appropriate by the utility to amend its rates;
- the use of the Consumer Price Index (CPI) to achieve efficiencies in the administrative and operating costs of PGL;
- the use of a prescribed formula for the calculation of Allowed Revenue in PGL's determination of its rates in years other than a rate review year.

The major deficiencies in the proposed regulatory arrangements for PGL are in the regulatory authority and the regulatory processes. This report recommends modifications of these arrangements as follows:

Authority

- The regulator would have the authority to hire staff as necessary.
- The regulator would approve estimated changes in rate base in 1992 and the years following.
- The regulator would also approve actual rate base changes pertaining to the same years when the actual costs are known.
- The regulator would have the authority to order a hearing into rates at any time after new rates are filed by PGL.
- The regulator would have the authority to set accounting policies and financial reporting requirements for PGL.

- The regulator would have the authority to establish a policy for the award of intervenors' costs of a hearing.

- Regulations under the DGRR Act would set the conditions of access and services, including customer contribution requirements.

- The regulator would have the authority to review all costs of service in a rate review year.

- The prescribed formula for Allowed Revenue would include a correction factor for transmission costs, costs of gas, and other truly non-controllable expenses, but not long-term interest expense or depreciation differences, except on approved rate base changes.

- The regulator would have the authority to hold depreciation hearings, and to amend depreciation rates and schedules at any time.

- The responsibility of the regulator to set rates which would "ensure the financial viability" of PGL would be deleted.

Process

- The restrictions on holding hearings no more frequently than every three years would be deleted.

- It is recommended that the Oil and Gas Conservation Board (OGCB) regulate both TransGas Limited and Provincial Gas Limited. The OGCB would regulate these two utilities under authority from different statutes and would regulate by different regulatory processes as outlined in those statutes. There would be significant benefits derived in the quality of regulation and in the resolution of issues pertaining to cost allocations between the utilities if there were one regulator for both utilities.

It is concluded that, with the changes summarized above, the regulatory arrangements for TransGas Limited and Provincial Gas Limited will result in efficient and effective regulation, achieving a better balance of the interests of the utilities, their customers, and public policy objectives.

Appendix I

Highlights of the Regulatory Authority and Procedures of:

- British Columbia Utilities Commission
- Alberta Public Utilities Board
- Ontario Energy Board

Highlights of the Alberta Public Utilities Board Act

The Alberta Public Utilities Board is established pursuant to the Alberta **Public Utilities Board Act** (RSA 1980 ch. P-37 as amended). The Board is empowered to exercise a general supervisory function over all public utilities that are owned or operated by or under the control of a company subject to the legislative authority of Alberta. Examples of gas distribution and transmission companies subject to the Board are Nova Corporation of Alberta and Northwestern Utilities Limited.

The Board is comprised of up to nine full-time members appointed for ten-year terms by the Lieutenant Governor in Council. The Board may hire a secretary and such supervisory and professional staff as it requires, and may engage the services of technical experts and consultants. The Board may also avail itself of the services of any Provincial employees as it sees fit. Costs of the Board are a charge on the General Revenue Fund, although the Board itself may order by whom the costs of any of its proceedings are to be paid.

In terms of the scope of its powers, the Board is very similar to the British Columbia Public Utilities Commission. Points of similarity include:

- Like the B.C. Commission, the Alberta Board may conduct inquiries and hearings on its own initiative, or on the complaint of any person affected (Alberta specifically includes municipalities as applicants or intervenors), or at the direction of the Lieutenant Governor in Council.
- The provisions in the Alberta Act regarding the extension of service are essentially identical to those in the B.C. Act.
- The Board's powers regarding the establishment of standards or conditions of service are also very similar to those of the Commission.
- The requirement of regulated utilities that they provide to the Board, at least annually, a report of their operations and finances, and such other information as the Board deems necessary as and when it requires it, also parallels the provisions of the B.C. Act.

- The Alberta provisions regarding the "flow-through" of certain non-controllable costs such as the commodity price of gas are virtually identical to the B.C. provisions.

- The final relevant similarities are the prohibitory provisions regarding discrimination in rates or service, issuance of securities, and sale, disposal or encumbrance of assets.

The Alberta Act is somewhat more detailed in its description of the Board's powers in setting rates and rate base, although in practice these powers are not significantly greater than those of the B.C. Commission. In addition to fixing "just and reasonable" rates, the Board may also fix proper and adequate rates and methods of depreciation, standards of service, and extensions of that service. In fixing rates, the Board is also empowered to determine a rate base and a fair return thereon. Like B.C., Alberta has eschewed the formulaic approach to rate base, and instead merely specifies that in determining rate base the Board should consider "the cost of the property when first devoted to public use, [the] prudent acquisition cost to the owner of the public utility, less depreciation in respect of each, and to necessary working capital."

A unique aspect of the Alberta Act is the prohibition against "automatic increases" in rates, that is, the Board is enjoined against setting a rate that may be increased from year to year without a further application by the regulated utility to the Board. This clause would appear to prevent the flow-through of increases in controllable or non-controllable costs attributed to general price inflation.

The following regulatory decision is illustrative of a broad range of relevant issues and the Board's treatment of them:

Northwestern Utilities Limited and Public Utilities Board Alberta (February 1989)

Issue: Approval of a change in the existing rates, tolls and charges for gas supplied and services rendered

- **Cost of Service Studies (COS)** - Such studies document the manner in which embedded or historical utility costs are distributed among rate groups. Normally, the utilities file a study to determine whether the rates proposed are just and reasonable and not unjustly discriminatory or unduly preferential.

  In an earlier decision involving Consumers' Gas and the Ontario Energy Board, that Board commented that each of the studies is a snapshot in time and involves much judgement with regard to their application to rate setting. It suggested that the value of the studies lies in the trends that are disclosed by a series of studies and that the trends should be recognized in rate design.

  In this case Northwestern presented nine different studies to demonstrate the range of cost allocation procedures used in the industry. The most significant change in the methodology employed in the studies is in the number of functions to which costs have been assigned. The traditional COS study allocates costs to only four functions: (1) General; (2) Gas Supply and Related; (3) Transmission; (4) Distribution. The other studies have costs functionalized into ten different categories.

  The Board concurred with the Industrial Rate Interveners who claimed that the traditional COS study is deficient in that certain costs are assigned to those customers who do not give rise to such costs. In past decisions respecting Northwestern and other utilities, the Board indicated that a COS study reflecting appropriate cost causations is a key criterion in the design of fair and reasonable rates. The study should therefore measure as accurately as possible the costs imposed upon the system by the various rate classes. To this end, the COS study should attempt to reflect the underlying system costs such that each customer class is assigned costs that it gives rise to. The Board did not accept Northwestern's multiple cost study approach and instead adopted the method which was adopted in previous Board decisions. Northwestern was directed to adopt the study methodology that most appropriately reflects cost causation in future rate hearings.

- **Unbundled Transportation Service and Storage** - The issue of the storage of gas as an unbundled service was addressed in this hearing. A number of participants were of the view that storage is a separate and distinct function from the delivery service and it is not necessary for a utility to have storage services in order for it to provide transportation services (and therefore, it is not appropriate for the two services to be bundled into one pricing mechanism). It was suggested that storage be offered only to those customers who wished to use that portion of the system, and that they be required to pay for the service.

  The Board considered that storage is used both for pure storage purposes as well as for dealing with peak day requirements of the sales customers. It considered that the availability and security of supplies at peak times is necessary and critical for all Northwestern's customers. Therefore, allowing transportation customers the unlimited access to storage might impose a risk to other customers in the event that the former were to draw down on storage. The Board determined that storage facilities that are not used as "peaking facilities" could be considered as pure storage and could continue to be accessed by transportation customers through a tendering process, but otherwise storage costs would continue to be bundled with delivery services.

- **Lost and unaccounted for Gas** - In this hearing, as in other decisions, the Board indicated that lost and unaccounted for gas is treated with a gas line loss percentage applied to each of the customer groups. The line loss factor is based on the average loss over a five year period. Northwestern advocated that since the line loss is the difference between total receipts to the system and deliveries to all customers, the fairest method of allocating the cost is on the basis of throughput, as described above. A more precise assignment cannot be made since it would require the measurement of unaccounted for gas.

  An argument was submitted that sales customers absorb their share of line loss without such cost being specifically identified and therefore the incentive to determine the responsibility for line loss does not exist. Northwestern suggested that a more accurate loss could be determined by reconciling actual line loss experienced by transportation customers to amounts actually paid by such customers. The Board found merit in the proposal but did not implement it directly.

Of further relevance to the Saskatchewan situation is the regulatory mechanism applied to Nova Corporation. The significant provisions of the **Nova Corporation of Alberta Act** (RSA, 1988, ch. N-12) as regards rate regulation are as follows:

- Nova is a corporation to which the Alberta **Business Corporations Act** applies as if it had been incorporated thereunder.

- The **Gas Utilities Act** does not apply to Nova or to its operations except with respect to gas purchased or owned by Nova.

- Nova shall fix, and vary, its rates, tolls and other charges, including the rates and methods of depreciation and amortization, determination of rate base and rate of return thereon.

- On complaint in writing of an interested party, the Public Utilities Board may, or on the direction of the Lieutenant Governor in Council shall, after notice to and hearing of the parties interested, determine the justness and reasonableness of the rates, tolls or other charges fixed or varied by Nova and by order in writing may vary or confirm the rates, tolls or other charges.

- When the Public Utilities Board varies a rate, toll or other charge, such order shall be in effect for a period not to exceed 12 months.

- Part 1 [administration of the Act and rights of the Board] of the **Public Utilities Board Act** applies with respect to matters within the jurisdiction of the Board.

- Rates, tolls and other charges of Nova shall be available for inspection during normal business hours.

- Nova shall from time to time define or prescribe terms and conditions of service applicable to its pipelines and other facilities (i.e., processing or treatment of gas, commingling or exchange of gas, adjust of contractual terms re: use of pipelines, etc.).

- On complaint in writing of an interested party respecting a decision made by Nova under section 39 [terms and conditions of service applicable to pipelines], the Energy Resources Conservation Board under the **Energy Resources Conservation Act** may, after notice to and hearing of the parties interested, determine the reasonableness of the decision made by Nova and by order in writing may vary or confirm the decision.

Highlights of the B.C. Utilities Commission Act

The British Columbia Utilities Commission, established by the **British Columbia Utilities Commission Act** (S.B.C. 1980, c. 60), regulates the production, generation, storage, transmission, sale and delivery of a wide variety of energy resources, including electricity and natural gas. The Commission is further responsible for the regulation of cable, microwave, optical fibre and radio communications which may be provided to the public for compensation. Municipally and regionally owned utilities providing services within their own boundaries are not subject to the Commission's regulation, and are instead regulated by their respective municipal or regional councils.

Under the provisions of the Act, the Commission is comprised of seven full-time commissioners who are appointed by and who serve at the pleasure of the Lieutenant Governor in Council for renewable five year terms. Temporary commissioners may also be appointed in the same manner to assist in the regulatory process. The Lieutenant Governor in Council is responsible for setting the remuneration of both full-time and temporary commissioners. The Commission is empowered to employ a secretary, other officers and employees as may be required and is responsible for determining their duties, conditions of employment and remuneration. Technical experts and consultants may also be appointed by the Commission to assist in carrying out its functions. The Commission is ultimately responsible to the Executive Council, and must file a report annually with the President thereof.

Although the Commission receives a budgetary allocation from the General Revenue Fund, in practice regulatory costs are recovered through a quarterly levy imposed on those public utilities subject to the Act.

The Commission functions as a quasi-judicial body whose jurisdiction extends to regulating the general conduct of public utilities' operations, equipment, appliances, safety devices, extension of works or systems, and the filing of rate schedules. The Commission's independence and scope of authority are limited by the Act, as it is required to comply with any general or special direction made by regulation of the Lieutenant Governor in Council with respect to the exercise of its powers and functions. For example, the Act restricts the removal of provincial energy resources without the direct approval and authority of the Lieutenant Governor in Council, who may direct the Commission to inquire into and report on such matters and provide recommendations to him. Similar provisions apply in respect of the granting of approval for new or expansion of existing projects.

Regarding matters related to its jurisdiction, the Commission may conduct hearings and inquiries of its own initiative, or in response to a complaint by either a public utility or an interested party. The Minister may also request the Commission to initiate hearings. Public hearings are held in respect of most matters brought before the Commission, although the Commission retains the right to conduct certain proceedings in camera.

The Commission has, by virtue of the Act, the power to approve or fix rates for the services or commodities provided by regulated public utilities. Regulated utilities are required to file with the Commission schedules of their rates, which are the only rates they may levy and which may not be amended without the approval of the Commission. The Commission is the sole judge of the extent to which those rates are "just and reasonable", and may so revise them as to realize those criteria. Discrimination in rates is prohibited, but the Act gives the Commission general guidance in setting rates whereby, for example, separate rates may be established for separate classes of service, or rates may recognize the special circumstances applicable to an area that is sparsely settled or has other distinctive characteristics.

Each rate application is reviewed on the basis of the applicant's submitted evidence, and all interested parties are given the opportunity to express their views during a public hearing. The Act requires that findings of fact guide the rate setting process, rather than predetermined benchmarks or precedent. Commission rulings are final, but on questions of law or jurisdiction there is an appeal process to the Provincial Court of Appeal.

Special provisions in the Act permit the "flow-through" of increases in the commodity price of natural gas or other non-controllable costs. In this event, the public utility must file with the Commission a new schedule of rates to reflect the increased costs; these rates may be implemented within 60 days after the Commission approves the new schedules. During that intervening period, a complaint by any person affected, or the Commission itself, may prompt an inquiry into the new schedule to determine whether it is just and reasonable.

Further provisions specify that the Lieutenant Governor in Council may make regulations empowering the Commission to restrict the sources from which or from whom industrial consumers may acquire natural gas. Where the Commission so restricts, the rate fixing powers of the Commission operate only in respect of that part of the natural gas that consists of transportation costs.

Unlike Saskatchewan's draft legislation, no specific guidelines or formulae appear in this Act regarding the fixing of rates, the definition of rate base, or the measurement of rate of return thereon. It can be presumed that the Commission's specific power to fix rates, and general powers to inquire into any aspect of the operations of a public utility it deems fit, give it the de facto authority to determine the components of rate base and the level of rate of return.

In addition to fixing rates, the Commission also has the authority to regulate a public utility's service levels. Where the Commission finds that, after a hearing held on its own motion or on complaint, the service of a public utility is unreasonable, unsafe, inadequate or unreasonably discriminatory, the Commission can determine what is reasonable, safe, adequate and fair service and order the utility to provide it. The Commission can also order a public utility to make an extension of an existing service which is deemed to be in the public interest. For instance, on the complaint of a municipality, the Commission, after a hearing, may order an extension of the existing service within the municipality, and may specify the apportionment of the costs of the extension between the municipality, the public utility and the consumers of the service.

The consolidation, amalgamation or merger of public utilities is subject to consent by the Commission, to which the public utility must first apply. After a hearing process, the Commission must report its consent to the Lieutenant Governor in Council. A public utility may also not issue any securities, including shares or debt instruments with maturities extending beyond one year, without making application to the Commission and receiving its approval.

Two recent published decisions of the Commission are illustrative of the reasoning the Commission employs in applying the provisions of the Act to regulated public utilities in British Columbia:

Inland Natural Gas Co. Ltd. and British Columbia Utilities Commission (December 1987)

Issue: Rate Design - Competitive versus cost-based rates

In this case, the Commission laid down principles to guide the rate design for Inland Natural Gas Co. Ltd., which sought to amend its tariffs to make industrial rates more market-based and residential and commercial rates more cost-based.

As regards a jurisdictional issue, the Commission upheld that while utilities under its jurisdiction are entitled to have rates fixed that recover cost of service, the **Utilities Commission Act** does not require that the rates for each class of customer be cost-based. In addition, the Commission indicated that when fixing rates, consideration is given to other issues, such as historic and marginal cost, provincial and national policies regarding energy pricing, the ability of consumers to pay for services, the diffusion of social benefits and a balancing of all regulated pricing objectives, including economic efficiency.

Sections 64, 65 and 66 of the **Utilities Commission Act** provide the Commission with the jurisdiction to fix rates for utility service. The Act effectively sets out upper and lower limits within which the Commission can then fix just and reasonable rates. The upper limit is determined by the value of service, while the lower limit is that which will allow an applicant to recover the cost of providing the service.

In an earlier decision, the Supreme Court of Canada (British Columbia Electrical Railway Co v. The Public Utilities Commission of B.C. - 1960) ruled that when dealing with a rate case, the Commission has unlimited discretion as to the matters which it may consider as affecting the rate, but when it sets the rate it must meet the two following requirements: (1) exhibit due regard for the protection of the public from rates that are excessive, and (2) give to the public utility a fair and reasonable return to enable the public utility to furnish the service.

In its decision, the Commission agreed with Inland's submission that the Utility is entitled to have rates fixed which allow it the opportunity to recover costs of services, if market circumstances permit. The Commission disagreed, however, with the suggestion that the Act requires there be cost-based rates for each class of customer. If this were the case, there would be no need for the just, reasonable and not unduly discriminatory standard which is expressly provided for in the Act. Such an objective, in the opinion of the Commission, ignores such factors as the accuracy of cost analysis, impact of alternative cost allocation methods, customer class risk, competitive market realities and investment decisions already made. The Commission considered instead that large industrial customers could be divided into two classes - captive and non-captive, thereby defining customer classes, in part, by their demand characteristics.

Inland Natural Gas Co. Ltd. and British Columbia Utilities Commission (June 1987)

Issue: Rate design - Transportation tariffs

In this decision, the Commission gave direction on 14 issues related to the transportation tariffs of Inland Natural Gas. Decisions on issues of broader significance are documented below:

Inland was the first utility in British Columbia to file Transportation Rate Schedules with the Commission following the deregulation of the natural gas industry in British Columbia. Inland's rates were accepted by the Commission on an interim basis recognizing, however, that Inland's transportation service functions would have to be reviewed more fully. Such a review was particularly pressing since at the time the Commission was aware of several complaints regarding the Inland Transportation Schedules. This review was undertaken as part of the Inland Rate Design Application, heard in June 1987.

- **Price Methodology between Schedules** - In considering the matter of pricing at this stage, the Commission indicated that the base rate for comparable sales and service schedules should be consistent. The schedule proposed by Inland provided for a level of parity in pricing between similar types of utility sales and transportation service. The Commission indicated further that when it considers benefits or added costs which may adjust the overall rate of a particular schedule, care must be taken to incorporate only real costs which a customer choosing transportation service imposes on the remaining sales customers.

- **Confidentiality of Prices** - The Commission ruled on the issue of confidentiality of prices, and indicated that it strongly supports the notion that margins for monopoly transportation sales and services should be made public.

A further matter of relevance to the proposed Saskatchewan regulatory situation is the sequence of events by which the gas assets of the British Columbia Hydro and Power Authority (the "Authority") were sold to Inland Natural Gas Co. Ltd. ("Inland Natural Gas"). The schematic diagram on page I-17 shows the process by which the privatization was accomplished. The Province incorporated a new share capital company, B.C. Gas Inc., into which were transferred the gas assets of the Authority. All of the shares of B.C. Gas Inc. were then sold to Inland Natural Gas. Subsequent thereto, Inland Natural Gas and its subsidiaries, Columbia Natural Gas Ltd. and Fort Nelson Gas Ltd., amalgamated to form B.C. Gas Inc.

The enabling legislation was the **Hydro and Power Authority Privatization Act** of 1988, which granted powers to the Lieutenant Governor in Council for:

- the establishment of an "intermediary company" or "gas distribution intermediary company" in which only the Government or the Authority can own shares (i.e., B.C. Gas Inc.);
- the transfer of the gas assets of the Authority to such an intermediary company or gas distribution intermediary company;
- the transfer of the assets of such an intermediary company or gas distribution intermediary company to a "successor company" owned by a person other than the Government or the Authority (i.e., Inland Natural Gas);
- prescribing that certain provisions of the **Utilities Commission Act** or the **Gas Utility Act** do not apply in respect of the intermediary company or the gas distribution intermediary company or the successor company;
- transfer to the Lieutenant Governor in Council of all of the "rights, powers, obligations, duties and functions" of the B.C. Utilities Commission for all purposes of the **Utilities Commission Act** and the **Gas Utility Act**; the Lieutenant Governor in Council has

"absolute discretion" as regards holding hearings, giving notice, disclosing reasons, etc.; the Lieutenant Governor in Council may "consult" with the Commission as he requires; the Lieutenant Governor in Council may order that the Commission shall exercise any of the regulatory powers transferred to him, save the privilege of "absolute discretion";

- transfer of employees, their pension rights, job security, etc.;
- disposition of privatization proceeds, which are not specifically directed to the reduction of debt in the Authority or the intermediary company, but can be paid directly into the consolidated revenue fund of the Province;
- disposition of the Government's shares in the intermediary company to any person, or capitalization of that intermediary company through a public offering of shares.

Certain sections of the **Hydro and Power Authority Privatization Act** are repealed effective October 1, 1991 at which time the successor company will be fully subject to the provisions of the **Utilities Commission Act** and the **Gas Utility Act**, unless the Lieutenant Governor in Council orders otherwise. In discussion with officials of the Commission, they disclosed that the Commission currently acts on behalf of the Lieutenant Governor in Council as the "informal" regulator of the successor company.

By Order in Council No. 1824, dated September 30, 1988, under the provisions of ss. 13(3) of the **Hydro and Power Authority Privatization Act**, the Lieutenant Governor in Council ordered the enablement of the terms of a Rate Agreement between the Province and Inland Natural Gas, the essential terms of which are as follows:

- As part of its proposal to purchase the shares of B.C. Gas Inc. from the Province, Inland Natural Gas offered to limit changes in the rates paid for natural gas by customers of the utility to:

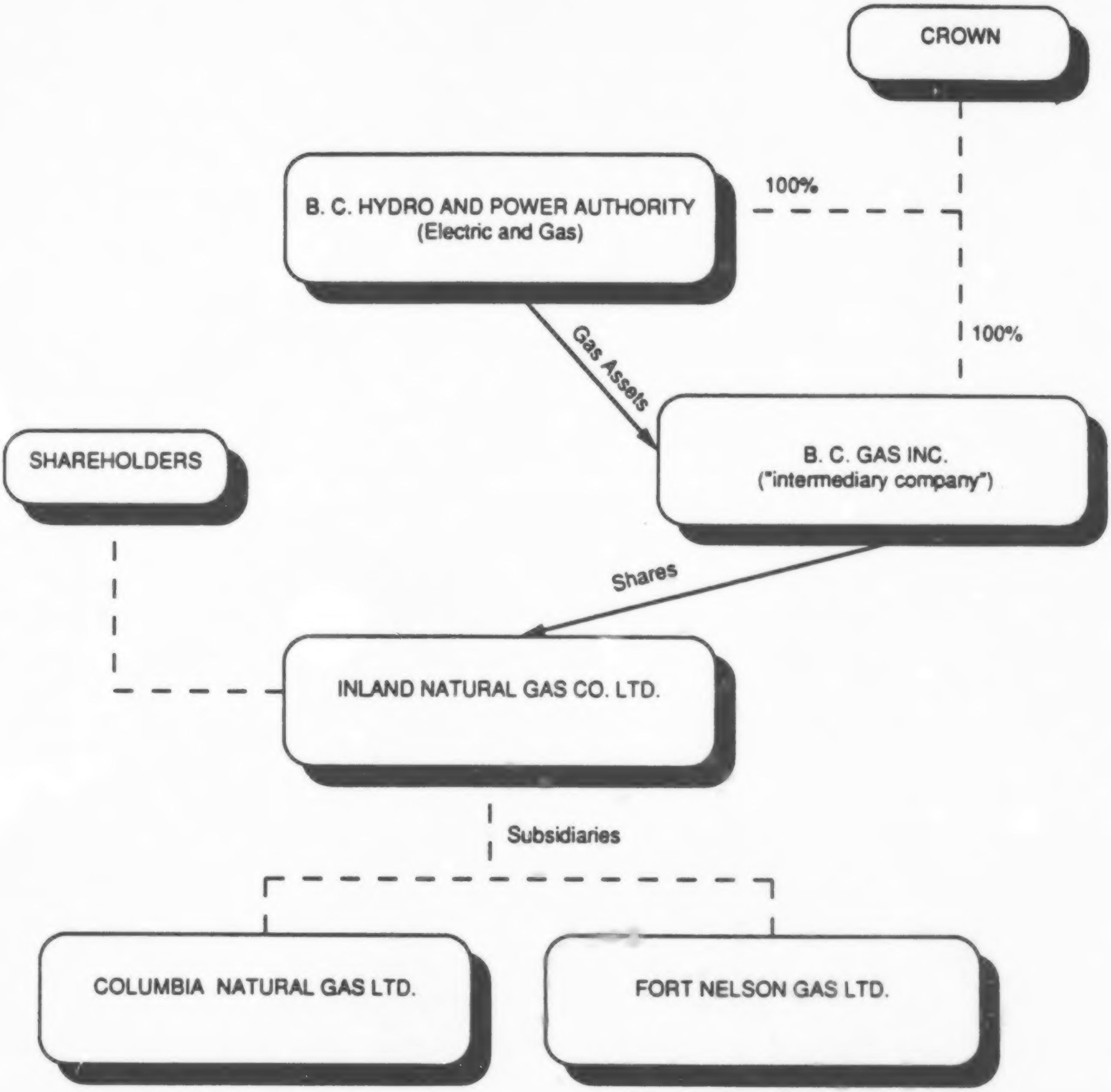
  - changes arising from changes in expenses over which Inland Natural Gas and its subsidiaries have no effective control, and,
  - changes associated with decisions of the Commission previously made,

  subject to the rates not being altered by or on the application or complaint of any person.

- Inland Natural Gas and its subsidiaries are to give written notice to the Minister of Energy, Mines and Petroleum Resources of any changes in:
  - natural gas commodity purchase prices,
  - the tolls, approved by the National Energy Board, of Westcoast Energy Inc. and of Alberta Natural Gas Co. Ltd.,
  - the amounts payable by Inland and its subsidiaries to Westcoast Energy Inc. arising from changes in contract demand or interruptible natural gas that are caused other than by variations in the number of customers or customer consumption of gas,
  - the rates of or method of calculating property taxes,
  - the rate of any tax payable by B.C. Gas Inc. under the **Municipal Act**,
  - the rate of any municipal franchise fees,
  - the rate of Federal and Provincial income tax applicable to utility operations,
  - weighted monthly average interest rate on short-term debt.
- Inland Natural Gas and its subsidiaries are to maintain "deferral accounts" to track the above costs. At least annually up to September 30, 1991, Inland et al. are to file with the Minister new schedules of rates which reflect a 12 month amortization of the total amount

charged to the deferral accounts. For the three-year period commencing September 30, 1988 Inland Natural Gas and its subsidiaries shall not change their existing rates other than as provided for in the Rate Agreement.

B. C. GAS PRIVATIZATION


CROWN
100%
B. C. HYDRO AND POWER AUTHORITY
(Electric and Gas)
100%
Gas Assets
SHAREHOLDERS
B. C. GAS INC.
("intermediary company")
Shares
INLAND NATURAL GAS CO. LTD.
Subsidiaries
COLUMBIA NATURAL GAS LTD.
FORT NELSON GAS LTD.

The Ontario Energy Board, established by the **Ontario Energy Board Act**, (RSO 1980, Chapter 332) regulates the transmission, distribution and storage of gas, including natural gas, manufactured gas, propane air gas, or any mixture thereof, substitute natural gas and synthetic gas. The Board consists of five members who are appointed by and who serve at the pleasure of the Lieutenant Governor in Council. The Board is empowered to employ a secretary and assistant secretary, as well as other officers and employees considered necessary. In addition, the Board may appoint technical consultants to assist in the regulatory process. The Board is ultimately responsible to the Executive Council and is required to file an Annual Report with the President thereof. The Board is funded from the General Revenue Fund.

The Board has exclusive authority over all matters conferred on it by the Ontario Energy Act. The Board has, by virtue of that Act, the power to approve or fix rates for the sale, transmission, distribution and storage of gas. Similar to the B.C. Utilities Commission, the Ontario Energy Board does not regulate the rates and charges of municipal public utilities which operate under the Public Utilities Act. Special provisions of the Ontario Energy Board Act specify the treatment of Ontario Hydro.

In fulfilling its regulatory role, the Board has the authority to hear and determine all questions of law and of fact. However, generally speaking the Board is not empowered to make any order or proceed in accordance with any reference or order in council until it has held a public hearing. The Board may conduct hearings and inquiries on its own initiative, upon the request of the Lieutenant Governor in Council or the Minister, or in response to a complaint filed by either a public utility or an interested party.

With respect to questions on law or jurisdiction, there is an appeal process to the Divisional Court. Board orders, however, are not suspended simply by virtue of an appeal proceeding, and continue in effect until the appeal is finalized. The appeal process for other matters within the Board's jurisdiction allows parties to petition the Clerk of the Executive Council, whereupon the

Lieutenant Governor in Council may confirm, vary or rescind the Board's order either in whole or in part. As part of this appeal process, the Lieutenant Governor in Council may require the Board to hold a new public hearing; however, amended Board orders may not be challenged.

The disposition of gas systems and amalgamations with other companies may not occur without the prior approval of the Lieutenant Governor in Council. In addition, approval from the Lieutenant Governor in Council is required for the acquisition of shares in excess of 20% of any class of shares in a gas transmitter, distributor or storage company.

The Lieutenant Governor in Council limits the scope of the Board's authority by reserving the right to make regulations on a number of issues, including fixing rates or other charges, limiting rights to use or consume gas at no charge or at a reduced rate, prescribing duties of officers of the Board, secretary and assistant secretary, prescribing fees payable to the Board, exempting parties from compliance with the Act, and generally respecting matters related to carrying out the intent and purpose of the Act.

In approving or fixing rates and other charges, the Board is responsible for determining a rate base for transmitting, distributing and storage companies, and further determining whether the return on the rate base produced is reasonable. Guidelines are provided in the Act for the determination of the utility's rate base: it is the total of a reasonable allowance for the cost of the property that is used in serving the public, less an amount determined by the Board for depreciation, amortization and depletion, plus a reasonable allowance for working capital and other amounts which in the opinion of the Board ought to be included. In addition, the Board may, at the request of any applicant and without a hearing, make one or more orders setting interim rates for a period not exceeding one year. Moreover, in certain circumstances the Board may dispense with the determination of a rate base. For example, in the case of a transmitter, distributor or strorage company that has been carrying on a business for less than two years or where such organization is operating at a loss, the rate base may be dispensed with.

There are a wealth of published regulatory and judicial decisions which show the scope of authority of the Board and the interpretation placed on certain sections of the Act. The following decisions illustrate a broad range of relevant issues:

Consumers' Gas Company and the Ontario Energy Board (December 1988)

Issue: Rate Application

The following selected Board comments and decisions are from the Rate Application submitted by Consumers' Gas Company in December 1988:

- **Regulation of Ancillary Activities (Merchandise Sales and Financing Programs)** - Board Staff indicated that the various ancillary activities that Consumers' Gas has been involved in present problems of regulation for the Board, and that the merits of including these activities within the regulated utility should be reviewed regularly to determine whether their inclusion is appropriate. The Board submitted that when looking at the issue of including an activity in the Utility's operations, the Board should examine: (1) whether the activity involves an enterprise with monopolistic power; (2) whether the activity requires that regulation is needed to simulate competition and ensure fair pricing and; (3) whether the activity directly involves the transmission, distribution and sale of natural gas.

- **Property Sales** - On the issue of two property sales and proceeds, the Company indicated that little precedent had been set in this area. It cited one decision where the Board decided that proceeds should accrue 100% to the customers, but should be shared 50/50 between customers and shareholders in another. The Board concurred that the matter of the treatment of land for rate making purposes is without clear precedent and in the Board's opinion, required additional review. For the purpose of this decision, the Board accepted the Company's proposal that the profits of property sales be equally divided between the customers and the shareholders.

- **Budget Process** - One general point emerged from the documentation on the applicant's budgetary process. Board Staff in this portion of the hearing urged the Board to be cautious in accepting the Company's budget forecasts due to the possible incentive for the Company to understate forecasted customer additions (since this results in an increased opportunity for the utility to over-earn.) The Board disagreed with the Board Staff, and determined that the Company was exerting commendable efforts to tighten its budget. In this partial decision, as in others, it appears that the Board can refer to Board Staff's comments and concerns, but is under no obligation to rule in accordance with their comments.

- **Rate Hearing Expenses** - Must also be reviewed and approved by the Board. To the extent that they are approved by the Board, regulatory expenses appear to be included for recovery in rates in subsequent test years.

- **Accumulated Depreciation** - In the previous main rate case, the Board instructed the Company to undertake a study to arrive at revised depreciation rates for each asset class. The Board indicated that it has some concerns with the on-going treatment of assets which may no longer be used or are useful, and its view is that the Company has a responsibility to ensure that its rate base contains only those items which are being used or will be useful for customer service in the future.

- **Rate Handbook** - Certain disclosure requirements were ordered by the Board in order that the rate schedules published by the Company would assist customers in understanding the scheduled rates and options.

Consumers' Gas Company and Ontario Energy Board

Issue: Rate setting and Gas Costs

- **Board Jurisdiction and the 1988 Agreement** - The 1988 Agreement entered into by Consumers' Gas, two other major Ontario gas utilities and TransCanada Pipelines Ltd. and its subsidiary Western Gas Marketing Ltd. introduced changes in the way gas is sold and delivered to Ontario. Prior to the Agreement, natural gas prices to end-use customers were bundled into one price, which included commodity, transportation, distribution and load balancing costs. The 1988 Agreement changes the pricing such that gas supply pricing is "unbundled" from transportation pricing. At the hearing, the Board indicated that it did not have the jurisdiction to rule on the prudence of the 1988 Agreement, despite requests to do so from participants. The Board indicated that its statutory power is limited to the terms and conditions specifically provided for in the Act.; in this case, to determine the reasonableness of the gas cost flowing from the 1988 Agreement.

- **Gas Cost Consequences of the 1988 Agreement** - Although the Board was not prepared to comment on the prudence of the 1988 Agreement, it was prepared to review the Agreement from the point of view of reasonableness of gas costs.

  A number of participants argued that the endorsed cost of gas should reflect a competitive marketplace. This assumes that a "fair and reasonable price" would be equal to the competitive price - any amount above the competitive price would therefore be a premium. The Board concluded, however, that portions of the Agreement serve to depress cost factors, while others serve to increase costs, and since none could be quantified, a competitive price could not be determined. The Board could not therefore determine whether the Agreement's negotiated price contained either a premium or a discount.

In determining whether the 1988 Agreement reflected reasonable gas costs, the Board focused on an assessment of current circumstances, the negotiating process itself and the results obtained. In reaching the conclusion that reasonable gas costs prevailed, the Board also considered that:

- WGML was the only supplier capable of meeting the requirements of Consumers' Gas;
- the gas costs appeared to have resulted from aggressive negotiation between the parties involved;
- the Agreement contains changes that reflect the commercial interests of the parties, which further suggests that the negotiating process was successful;
- the Agreement contains several features that will further the development of the competitive market in Ontario.

- **Awarding of Costs** - In earlier decisions, the Board established the eligibility criteria for awarding costs. An important criterion is that the party seeking an award must have contributed to a better understanding of the issues presented. The report at hand indicates that each of the interveners were required to submit a proposal to the Board for compensation of reasonably incurred costs. One participant cited that in an earlier decision, the Board awarded interveners 60% of costs, and in some cases a greater amount was reimbursed. Interveners who are entitled to a reimbursement of costs are also required to file a statement of costs with the Board and the Applicant, whereupon the Board orders the Applicant to reimburse the costs.

With respect to Board costs associated with the hearings, the Board ruled that the Applicant would bear the cost of the proceedings.

APPENDIX A10

KPMG Peat Marwick

Report to the

Barber Commission

Analysis of the Impact of the Proposed SaskEnergy Share Offering on SaskPower Rates

September, 1989

TO: THE BARBER COMMISSION

The purpose of this letter is to report our findings as a result of our engagement by the Commission to assist in the analysis of certain aspects of the impact of a public share offering by Saskatchewan Energy Corporation ("SaskEnergy") on the rates charged to consumers for electricity by Saskatchewan Power Corporation ("SaskPower").

In accordance with the terms of our engagement letter dated August 25, 1989, the scope of our analysis has been limited to the following:

- tracing the flow of the net proceeds of the public share offering from SaskEnergy to SaskPower;
- reviewing the timing and amount of the application of those funds to reduce SaskPower's debt and related interest cost;
- assessing the impact of the debt reduction in SaskPower on rates charged for electricity.

In undertaking this analysis, we have relied upon the following:

- the briefs submitted to the Commission by SaskEnergy and SaskPower;
- certain additional information (referred to as the "undertakings") supplied to the Commission at its written request by SaskEnergy and SaskPower;
- the Preliminary Prospectus provided to the Commission by SaskEnergy;
- certain contracts material to the public share offering, referred to as the "Asset Transfer Agreement" and the "Debt Agreement";
- additional financial information provided to us by SaskEnergy and SaskPower;
- representations made and explanations given to us by the senior management of SaskEnergy and SaskPower.

1. The Flow of Funds

The flow of the net proceeds of the public share offering from SaskEnergy to SaskPower is one element in a series of financial transactions between the two companies. As we understand it, this sequence of transactions is as follows:

Step 1: Transfer of Gas Division Assets

The gas transmission, distribution and storage assets of the gas division of SaskPower are transferred to SaskEnergy at their appraised value, which is significantly in excess of their book value. SaskEnergy provides consideration in the form of promissory notes payable to SaskPower (the "SaskPower notes"). SaskPower also agrees to provide non-interest bearing cash advances to SaskEnergy for working capital subsequent to the transfer up to the time of the initial public offering of shares.

Step 2: Initial Public Offering of Shares in SaskEnergy

There is an initial public offering of the shares of SaskEnergy. Of the SaskPower notes, a portion equivalent in value to 40-60% of the total share capital of SaskEnergy is converted into SaskEnergy common shares, which are held by SaskPower. The net cash proceeds of the public sale of shares to residents of Saskatchewan are received by SaskPower in payment of a further portion of the SaskPower notes.

Step 3: Refinancing of Debt

For the remaining SaskPower notes, SaskEnergy refinances this obligation by a variety of debt instruments and repays SaskPower in full. In terms of relative dollar amounts, this refinancing transaction is considerably more significant than the transfer of the proceeds of the sale of shares.

2. Timing and Application of Funds

The funds received by SaskPower from the sale of shares by SaskEnergy and the repayment of debt by SaskEnergy will be applied as follows:

- to meet existing debt obligations as they come due;
- to retire certain debt prior to its maturity date, subject to market conditions;
- to finance current capital expenditures.

The impact of the application of these funds is reflected in the pro forma financial statements provided to the Commission by SaskPower. We have reviewed these pro forma financial statements with the senior management of SaskPower. Our analysis of the pro forma financial statements provided by SaskPower is included in the Appendix to this letter.

As regards the timing of the application of the funds, the pro forma financial statements assume, for purposes of simplicity, that the entire sequence of transactions is completed as of December 31, 1989 and the whole impact is recognized in 1989. While the precise timing of the initial public offering will be dependent on capital market conditions, it is expected to take place within three to six months following final passage of the required legislation. The refinancing of the remaining debt owing to SaskPower is expected to be completed within the same time frame. Any timing difference between the pro forma financial statements and proposed actual events is not expected to materially alter the financial position of SaskPower.

According to the management of SaskPower, the funds will be applied to specific debt obligations as they come due, to current financing requirements, and to retire high rate debt (subject to market conditions). The impact on total long-term debt in 1989 is readily apparent from the pro forma financial statements. It is not practicable to use the proceeds solely to retire the existing highest rate debt, as the premium costs might prove excessive. The scope of our analysis did not extend to identifying specific debt issues to be retired, but the trend of finance charges as a percent of total long-term debt indicates a reduction in SaskPower's debt costs over the period covered by the pro forma financial statements.

3. Impact of Debt Reduction on Electricity Rates

The pro forma financial statements provided by SaskPower cover three scenarios: without privatization of SaskEnergy, with privatization of SaskEnergy excluding the proposed economic incentive programs (economic diversification fund of $10 million per year for at least four years, 50% reduction in electricity bills for curling and skating rinks for at least four years, and an electrical discount plan for residential customers), and with privatization of SaskEnergy including the proposed economic programs. In all cases, revenue from electricity sales increases by 3% per year, compounded, over the 1988 base amount. Insofar as SaskPower shows significantly greater profits under either of the privatization scenarios than under the "without privatization" case, it can be concluded that the impact of the debt reduction in SaskPower following upon the privatization of SaskEnergy produces a net benefit to SaskPower and its customers.

Several caveats to this general conclusion should be noted:

- In the "without privatization" case, SaskPower continues to generate profits, despite electrical rate increases held to 3% and an increasing debt load, at least through 1993. In addition, the real cost of service in constant 1981 dollars continues to decline "with" or "without" privatization over the same period. Long-term debt as a percent of total capital also declines "with" or "without" privatization, while finance charges as a percent of revenue increase only slightly.

- The cost of the economic incentives program, over the period 1990-93, is to reduce SaskPower's net income by an estimated $108 million relative to the "with privatization excluding economic programs" scenario. SaskPower's assertion that the benefits of the economic incentives program can only be passed on under the privatization scenario remains to be proven, as a further scenario should be presented, that of "without privatization including economic incentive programs".

- The payment of dividends by SaskPower has not been presented in the pro forma financial statements. In our assessment, the payment of dividends under either the "with" or "without" privatization scenarios could result in a material change in the financial position presented.

- Apart from the Extraordinary Gain recognized in 1989 relating to the disposal of its investment in SaskEnergy, the net impact in terms of increased net incomes to SaskPower becomes greater in later years than in 1989 or 1990. As financial results are projected farther into the future, they become more sensitive to changes in interest rates, foreign exchange rates, construction costs and other factors.

- As noted earlier, within the proposed series of transactions between the two companies, a significantly greater proportion of SaskPower's existing debt is reduced by virtue of SaskEnergy's refinancing of the SaskPower notes than by the proceeds of the sale of shares to the public. To the best of our understanding, the differential impact of either of these transactions considered as a separate event has not been determined.

Several other issues in respect of this transaction should also be noted:

- In effect, this series of financial transactions allows SaskPower to realize on an increase in value of its gas division assets (note that the appraised value is significantly in excess of the historical cost). SaskEnergy then refinances these assets, and pays SaskPower for them. Whether this refinancing by SaskEnergy is accomplished through equity or debt instruments is irrelevant to SaskPower's financial position. To put SaskEnergy in a healthy financial situation, however, some appropriate mix of debt and equity would be required.

- The question might arise as to whether the one-time impact of the debt reduction in SaskPower is greater than the present value of the expected future earnings of SaskEnergy as a Crown corporation. In our assessment, this question is founded on the following erroneous assumptions:

    - As can be seen in the SaskPower pro forma financial statements, the impact of the debt reduction extends and increases over time, and its benefits are not "one-time".

    - SaskEnergy's earnings are irrelevant in this context, although its cash flows are not.

    - The question assumes that SaskEnergy will have surplus cash flows (that is, cash flows greater than required for its own debt servicing and capital expenditure needs). While the scope of our engagement did not extend to an examination of the financial position of SaskEnergy, officials of that company have indicated to us that no such surplus cash flows are projected to arise over the period 1989-93.

4. Conclusions

Based on the limited scope of our review of the information provided to the Commission by SaskEnergy and SaskPower, and of certain other information provided to us by both companies, and based on the representations of the management of both companies upon which we have relied, we conclude that the proposed sale of shares of SaskEnergy to the public, together with the refinancing of the SaskPower notes and the repayment thereof to SaskPower by SaskEnergy, could allow SaskPower to hold electrical rate increases to 3% per annum, and to flow direct benefits to consumers through an economic incentives program, while attaining higher levels of profitability than would otherwise have been the case.

Appendix A

Analysis of SaskPower Pro Forma Financial Statements

CALCULATION OF IMPACT ON NET INCOME: INCOME INCREASED (DECREASED)

	C$millions	1989	1990	1991	1992	1993
	REVENUES					
[1]	Without privatization	690	721	752	803	857
[2]	With privatization excluding economic programs	721	745	782	835	891
[3]	With privatization including economic programs	721	721	767	833	889
	[2]-[1] = gross impact of privatization	31	24	30	32	34
	[3]-[2] = impact of economic programs	0	-24	-15	-2	-2
	[3]-[1] = net impact of privatization	31	0	15	30	32
	COSTS AND EXPENSES					
[1]	Without privatization	397	438	465	494	545
[2]	With privatization excluding economic programs	397	438	465	494	545
[3]	With privatization including economic programs	397	448	475	504	555
	[1]-[2] = gross impact of privatization	0	0	0	0	0
	[2]-[3] = impact of economic programs	0	-10	-10	-10	-10
	[1]-[3] = net impact of privatization	0	-10	-10	-10	-10
	FINANCE CHARGES					
[1]	Without privatization	192	192	196	226	244
[2]	With privatization excluding economic programs	185	152	143	161	161
[3]	With privatization including economic programs	185	154	148	169	171
	[1]-[2] = gross impact of privatization	7	40	53	65	83
	[2]-[3] = impact of economic programs	0	-2	-5	-8	-10
	[1]-[3] = net impact of privatization	7	38	48	57	73
	INCOME BEFORE EXTRAORDINARY ITEMS					
[1]	Without privatization	101	91	91	83	69
[2]	With privatization excluding economic programs	139	155	174	180	185
[3]	With privatization including economic programs	139	119	144	160	163
	[2]-[1] = gross impact of privatization	38	64	83	97	116
	[3]-[2] = impact of economic programs	0	-36	-30	-20	-22
	[3]-[1] = net impact of privatization	38	28	53	77	94
	EXTRAORDINARY ITEMS					
[1]	Without privatization	0	0	0	0	0
[2]	With privatization excluding economic programs	120	0	0	0	0
[3]	With privatization including economic programs	120	0	0	0	0
	[2]-[1] = gross impact of privatization	120	0	0	0	0
	[3]-[2] = impact of economic programs	0	0	0	0	0
	[3]-[1] = net impact of privatization	120	0	0	0	0
	NET INCOME					
[1]	Without privatization	101	91	91	83	69
[2]	With privatization excluding economic programs	259	155	174	180	185
[3]	With privatization including economic programs	259	119	144	160	163
	[2]-[1] = gross impact of privatization	158	64	83	97	116
	[3]-[2] = impact of economic programs	0	-36	-30	-20	-22
	[3]-[1] = net impact of privatization	158	28	53	77	94

CALCULATION OF IMPACT ON CASH FLOWS: INCREASED (DECREASED)

	C$millions	1989	1990	1991	1992	1993
	CASH FROM OPERATIONS					
[1]	Without privatization	380	420	410	397	462
[2]	With privatization excluding economic programs	426	430	442	488	525
[3]	With privatization including economic programs	426	402	416	475	513
	[2]-[1] = gross impact of privatization	46	10	32	91	63
	[3]-[2] = impact of economic programs	0	-28	-26	-13	-12
	[3]-[1] = net impact of privatization	46	-18	6	78	51
	DEBT SERVICING					
[1]	Without privatization	388	303	472	301	310
[2]	With privatization excluding economic programs	429	271	427	241	230
[3]	With privatization including economic programs	429	273	432	249	241
	[1]-[2] = gross impact of privatization	-41	32	45	60	80
	[2]-[3] = impact of economic programs	0	-2	-5	-8	-11
	[1]-[3] = net impact of privatization	-41	30	40	52	69
	CAPITAL EXPENDITURES					
[1]	Without privatization	224	346	349	255	335
[2]	With privatization excluding economic programs	224	346	349	255	335
[3]	With privatization including economic programs	224	346	349	255	335
	[1]-[2] = gross impact of privatization	0	0	0	0	0
	[2]-[3] = impact of economic programs	0	0	0	0	0
	[1]-[3] = net impact of privatization	0	0	0	0	0
	FINANCING REQUIRED					
[1]	Without privatization	189	241	411	159	183
[2]	With privatization excluding economic programs	268	106	334	12	36
[3]	With privatization including economic programs	268	136	365	30	63
	[2]-[1] = gross impact of privatization	79	-135	-77	-147	-147
	[3]-[2] = impact of economic programs	0	30	31	18	27
	[3]-[1] = net impact of privatization	79	-105	-46	-129	-120
	NET INCREASE (DECREASE) IN CASH					
[1]	Without privatization	-43	12	0	0	0
[2]	With privatization excluding economic programs	41	-81	0	4	-4
[3]	With privatization including economic programs	41	-81	0	1	0
	[2]-[1] = gross impact of privatization	84	-93	0	4	-4
	[3]-[2] = impact of economic programs	0	0	0	-3	4
	[3]-[1] = net impact of privatization	84	-93	0	1	0

ANALYSIS OF SASKPOWER PRO FORMA FINANCIAL STATEMENTS

CALCULATION OF IMPACT ON NET ASSETS: INCREASE (DECREASE)

	C$millions	1989	1990	1991	1992	1993
	TOTAL ASSETS					
[1]	Without privatization	2434	2721	3004	3172	3388
[2]	With privatization excluding economic programs	2797	3002	3281	3388	3567
[3]	With privatization including economic programs	2797	2998	3278	3384	3566
	[2]-[1] = gross impact of privatization	363	281	277	216	179
	[3]-[2] = impact of economic programs	0	-4	-3	-4	-1
	[3]-[1] = net impact of privatization	363	277	274	212	178
	TOTAL LONG-TERM DEBT (NET OF EQUITY IN SINKING FUNDS)					
[1]	Without privatization	1885	2042	2223	2331	2462
[2]	With privatization excluding economic programs	1600	1611	1707	1658	1639
[3]	With privatization including economic programs	1600	1642	1769	1737	1744
	[1]-[2] = gross impact of privatization	285	431	516	673	823
	[2]-[3] = impact of economic programs	0	-31	-62	-79	-105
	[1]-[3] = net impact of privatization	285	400	454	594	718
	OTHER LIABILITIES					
[1]	Without privatization	342	380	391	370	387
[2]	With privatization excluding economic programs	347	385	394	370	383
[3]	With privatization including economic programs	347	386	396	373	386
	[1]-[2] = gross impact of privatization	-5	-5	-3	0	4
	[2]-[3] = impact of economic programs	0	-1	-2	-3	-3
	[1]-[3] = net impact of privatization	-5	-6	-5	-3	1
	RETAINED EARNINGS					
[1]	Without privatization	207	299	390	471	539
[2]	With privatization excluding economic programs	850	1006	1180	1360	1545
[3]	With privatization including economic programs	850	970	1113	1274	1436
	[2]-[1] = gross impact of privatization	643	707	790	889	1006
	[3]-[2] = impact of economic programs	0	-36	-67	-86	-109
	[3]-[1] = net impact of privatization	643	671	723	803	897

CALCULATION OF MEASURES OF FINANCIAL PERFORMANCE

	C$millions	1989	1990	1991	1992	1993
	LONG-TERM DEBT (NET OF EQUITY IN SINKING FUNDS) AS % OF TOTAL CAPITAL:					
[1]	Without privatization	90.11%	87.23%	85.07%	83.19%	82.04%
[2]	With privatization excluding economic programs	65.31%	61.56%	59.13%	54.94%	51.48%
[3]	With privatization including economic programs	65.31%	62.86%	61.38%	57.69%	54.84%
	FINANCE CHARGES AS % OF REVENUE:					
[1]	Without privatization	27.83%	26.63%	26.06%	28.14%	28.47%
[2]	With privatization excluding economic programs	25.66%	20.40%	18.29%	19.28%	18.07%
[3]	With privatization including economic programs	25.66%	21.36%	19.30%	20.29%	19.24%
	NET INCOME BEFORE EXTRAORDINARY ITEMS AS % OF REVENUE:					
[1]	Without privatization	14.64%	12.62%	12.10%	10.34%	8.05%
[2]	With privatization excluding economic programs	19.28%	20.81%	22.25%	21.56%	20.76%
[3]	With privatization including economic programs	19.28%	16.50%	18.77%	19.21%	18.34%
	% OF CAPITAL EXPENDITURES INTERNALLY FUNDED:					
[1]	Without privatization	-3.57%	33.82%	-17.77%	37.65%	45.37%
[2]	With privatization excluding economic programs	-1.34%	45.95%	4.30%	96.86%	88.06%
[3]	With privatization including economic programs	-1.34%	37.28%	-4.58%	88.63%	81.19%

ANALYSIS OF IMPACT OF PRIVATIZATION

C$millions	1989	1990	1991	1992	1993
Gross Impact of Privatization	158	64	83	97	116
Less:					
Extraordinary Gain	120	0	0	0	0
Equity Earnings of SaskEnergy	31	24	30	32	34
Equals:					
Impact of Debt Reduction	7	40	53	65	82
Less:					
Cost of Economic Incentive Programs	0	-36	-30	-20	-22
Equals:					
Incremental Impact to SaskPower	7	4	23	45	60

YEAR	SALES VOLUME (000s GW.h)	TOTAL COST OF SERVICE (current $millions)		REAL COST OF SERVICE ($ per GW.h)				GDP Implicit Price Deflator 1981 = 100
				Current $		Constant 1981$		
		Without Privatization	Privatization inc. Economic Program	Without Privatization	Privatization inc. Economic Program	Without Privatization	Privatization inc. Economic Program	
1983	9.10	403	403	0.044	0.044	0.039	0.039	114.1
1984	9.86	460	460	0.047	0.047	0.040	0.040	118.0
1985	10.17	492	492	0.048	0.048	0.040	0.040	121.7
1986	10.37	528	528	0.051	0.051	0.041	0.041	125.3
1987	10.81	542	542	0.050	0.050	0.039	0.039	129.1
1988	11.42	571	571	0.050	0.050	0.037	0.037	134.3
1989	11.78	589	582	0.050	0.049	0.035	0.035	141.0
1990	12.30	630	602	0.051	0.049	0.035	0.033	148.1
1991	12.40	661	623	0.053	0.050	0.034	0.032	155.5
1992	12.88	720	673	0.056	0.052	0.034	0.032	163.2
1993	13.39	789	726	0.059	0.054	0.034	0.032	171.4

APPENDIX A11

Table IA

Summary of Dividend Payments by SaskPower to Provincial Government

YEAR	Dividend
1968	3,000,000
1969	3,500,000
1970	8,500,000
1971	10,400,000
1973	20,900,000
1976	3,600,000
1977	10,200,000
1978	8,200,000
1979	10,300,000
1980	16,500,000
1981	10,275,000

Table IIA

Comparison of Long Term Debt as a Percentage of Total Capital for Selected Electric Utilities - 1988

Utility		Generation	Debt as a % of Total Capital
B.C. Hydro		96% Hydro, 4% Thermal	92.3
Trans Alta Utilities	)		61.7
Alberta Power	)	96% Thermal, 4% Hydro	64.8
SaskPower		82% Thermal, 18% Hydro	94.6
Manitoba Hydro		94% Hydro, 6% Thermal	96.7
Ontario Hydro		47% Nuclear, 27% Hydro 26% Thermal	82.6
Hydro Quebec		96% Hydro, 4% Nuclear	73.8

Table IIIA

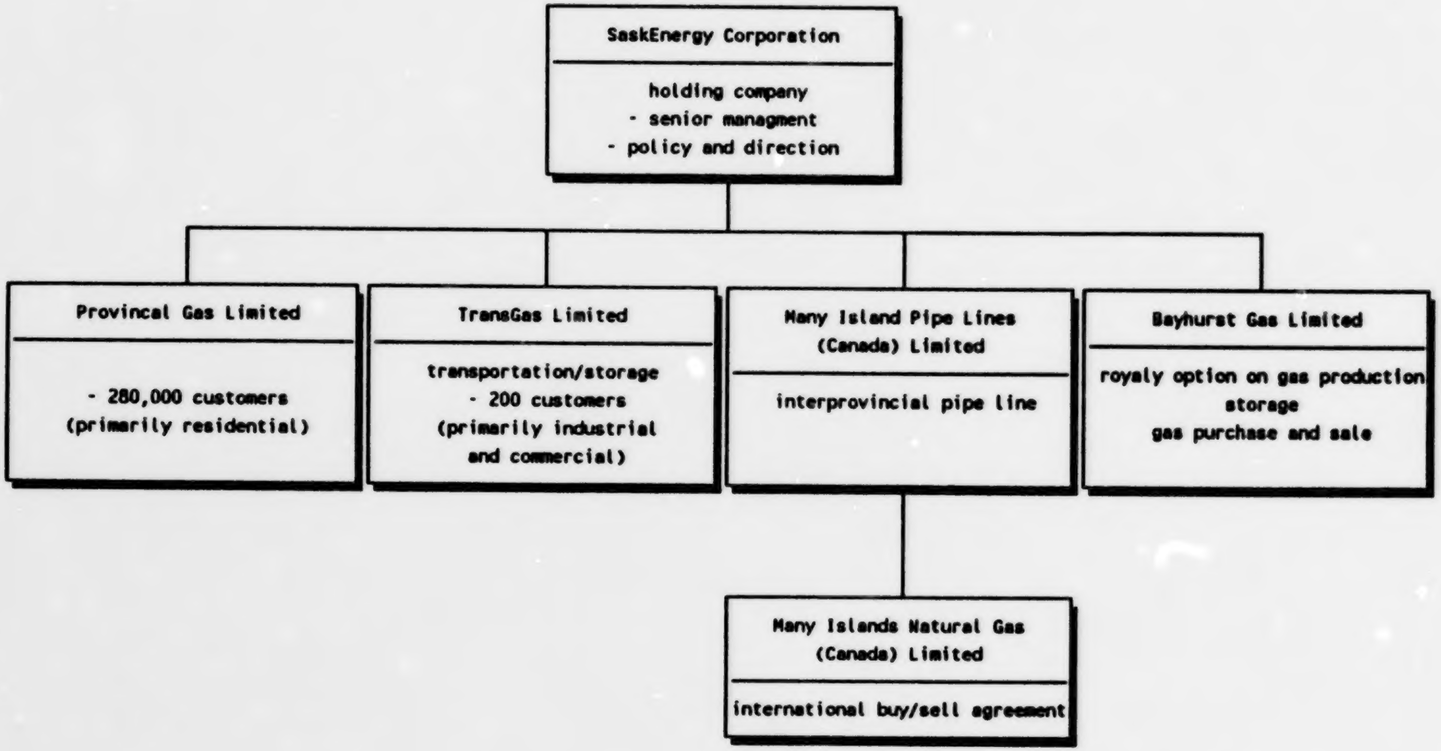
Average Monthly Electricity Bill for Residential and Commercial Consumers in Canada (1988)

City	Residential	Commercial
Vancouver	$37.04	$377.82
Calgary	$32.48	$449.44
Regina	$42.69	$567.38
Winnipeg	$33.03	$345.15
Toronto	$38.29	$479.76
Montreal	$33.48	$402.74
Moncton	$44.32	$539.77
Halifax	$47.34	$589.92

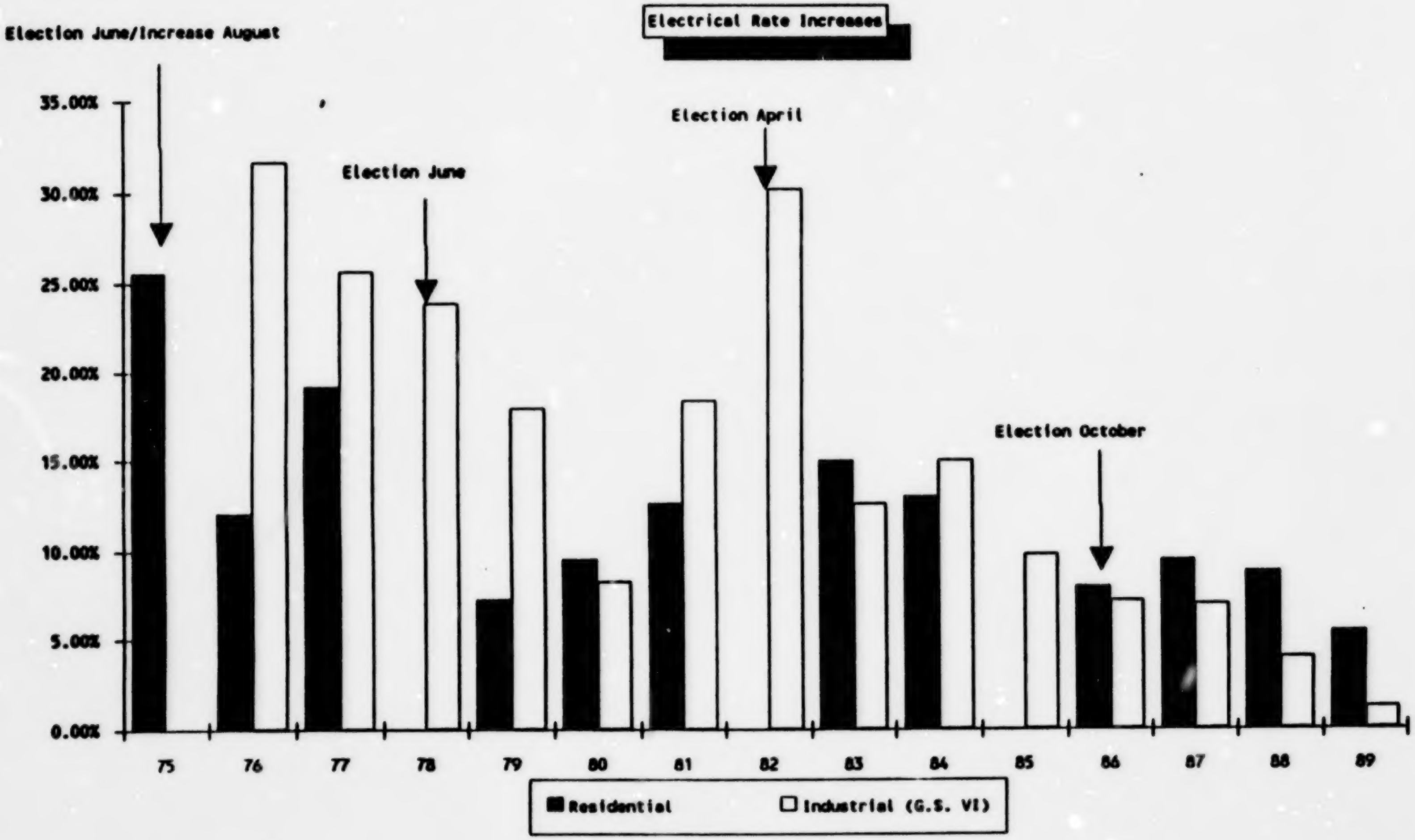
Residential = 600 kW/h
Commercial = 6200kW/h

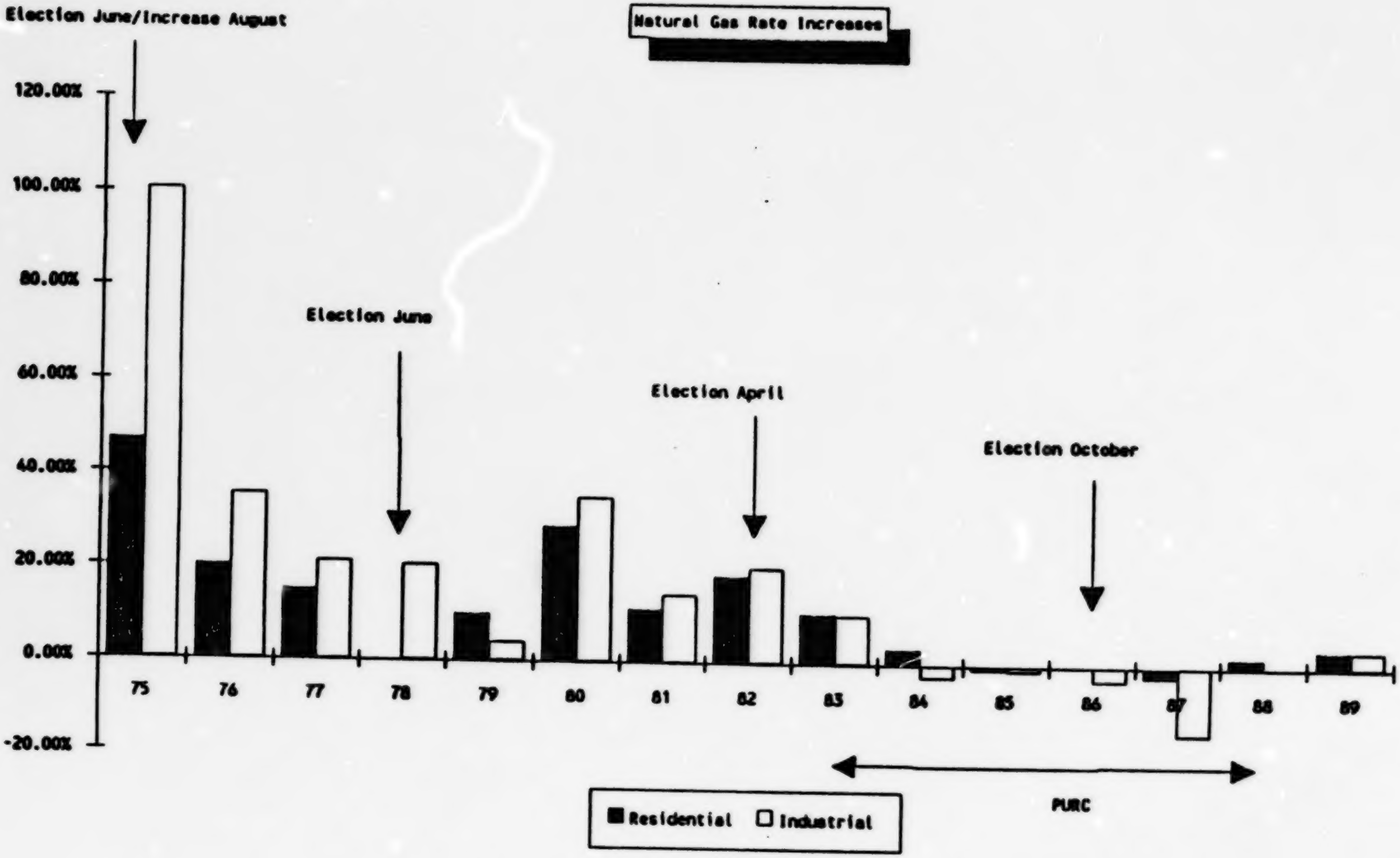
APPENDIX A12

SASKENERGY CORPORATE STRUCTURE


SaskEnergy Corporation
holding company
- senior managment
- policy and direction
Provincal Gas Limited
- 280,000 customers
(primarily residential)
TransGas Limited
transportation/storage
- 200 customers
(primarily industrial
and commercial)
Many Island Pipe Lines
(Canada) Limited
interprovincial pipe line
Bayhurst Gas Limited
royaly option on gas production
storage
gas purchase and sale
Many Islands Natural Gas
(Canada) Limited
international buy/sell agreement

APPENDIX A13


Electrical Rate Increases
Election June/Increase August
Election June
Election April
Election October
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
75
76
77
78
79
80
81
82
83
84
85
86
87
88
89
■ Residential
□ Industrial (G.S. VI)


Natural Gas Rate Increases
Election June/Increase August
Election June
Election April
Election October
120.00%
100.00%
80.00%
60.00%
40.00%
20.00%
0.00%
-20.00%
75
76
77
78
79
80
81
82
83
84
85
86
87
88
89
PURC
■ Residential
☐ Industrial